C-Share (Level Load) Conversion: Operational Considerations

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Contents

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Introduction

Many asset managers distribute their mutual fund portfolios in a "multi-class" structure. Each class is distinguished by unique shareholder eligibility requirements, services offered, and combinations of fees and expenses for fund distribution. These options help shareholders determine the best combination of features to meet their investment objectives. Fund documents such as prospectuses and statements of additional information (SAI) outline the available share class(es) for any given portfolio, disclosing applicable fees and expenses and describing shareholder eligibility and operating characteristics.[1]

Funds that charge shareholders fees and expenses for distribution are typically called load funds.[2] Examples of such fees and expenses paid by shareholders include a front-end sales charge,[3] contingent deferred sales charge (CDSC),[4] and a 12b-1 fee,[5] each of which may be deployed individually or in combination within a share class. For instance, a "level load" share class combines an annual 12b-1 fee (typically 1 percent) with a CDSC (also typically 1 percent) on shares sold within one year of purchase, while allowing investors to purchase shares at net asset value (NAV). Level load share classes are more commonly referred to as "Class C" or C shares.

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1 See Rule 18f-3 of the Investment Company Act of 1940 for general details and characteristics regarding multiple class funds.

2 A mutual fund that imposes a sales charge—either when fund shares are purchased (front-end load) or redeemed (contingent deferred sales charge)—or a fund that charges a 12b-1 fee greater than 0.25 percent. See www.icifactbook.org.

3 A fee imposed by some funds at the point of purchase to cover selling costs. Any front-end load imposed by a fund will be described in detail in the fund's prospectus. See www.icifactbook.org.

4 A mutual fund fee imposed by some funds on shareholders who redeem (sell back to the fund) shares during the first few years of ownership. See "contingent deferred sales load" at www.icifactbook.org.

5 A mutual fund fee, named for the SEC rule that permits it, used to pay distribution costs such as compensation to financial advisers for initial and ongoing assistance. See www.icifactbook.org.

One feature that many mutual funds are evaluating is whether, after a certain period, they can implement an automated conversion of C shares to other share classes.[6] Implementing a C-share conversion after the share class has been offered for some time can create significant operational and procedural challenges for the fund itself, the fund's transfer agent, and the intermediaries who service C share investors in traditional brokerage arrangements (for both taxable and retirement assets) and employer retirement plans. Some challenges and considerations include the following:

- The process would generally require fund boards to first approve the fund's policies related to a C-share conversion. Funds would then need to prepare appropriate amendments to fund documents[7] to incorporate a new or modify an existing conversion when operationally feasible, and to file such amendments with the Securities and Exchange Commission (SEC).
- Details to determine share age for conversion purposes are most easily collected upon inception of the fund—or at least when the shareholder's fund account is opened. The information is often not readily available or incomplete when collection is attempted after the fact. In addition, certain distribution channels that sell C shares are neither equipped to determine share age beyond the one-year CDSC nor to execute a C-share conversion.
- Sufficient lead time must be given to allow the fund's transfer agent and eligible intermediaries to comply with the fund's policies regarding conversion.
- Communication of fund policies to investors, intermediaries and their financial advisers is critical to understanding the timing and impact of the C-share conversion.

To assist funds and intermediaries that are considering or are in the process of implementing C-share conversions, the Investment Company Institute's Broker/Dealer Advisory Committee (ICI BDAC) convened a working group of members to document operational considerations and common practices for C-share conversions. This paper:

- provides background on key C share attributes to support a conversion;
- outlines fund and intermediary considerations when deciding to pursue a C-share conversion;
- discusses the role of communication in implementing a successful conversion;
- describes considerations for determining conversion-eligible shares (and related shareholders); and
- highlights conversion and post-conversion considerations.

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6 Many C share prospectuses permit shareholders moving from a brokerage to advisory (asset-based fee) servicing arrangement to complete a one-time conversion of C shares into another share class within the portfolio that is designated for advisory programs. Such conversion eligibility is not affected by length of investment in the C-share class but may be subject to satisfying CDSC obligations before converting.

7 When adopting or amending a share class conversion policy, a fund may be required to amend its prospectus and/or SAI and file the amended documents with the Securities and Exchange Commission (SEC). The fund may be required to include, as an exhibit to the filing, its Rule 18f-3 plan (governing multiple classes of shares and share class conversions), including any agreements relating to the plan's implementation, and any amendment to the plan.

The paper may identify, but does not endorse, any specific policies that may be required prior to initiating a conversion. Funds should independently evaluate their need to implement a C-share conversion and consider the applicability of key operational components highlighted in this paper.

Background

Converting mutual fund shares from one share class to another within a portfolio is not a new concept. Automatic B-share[8] conversions have been common since their inception for those funds and intermediaries that offer the share class. The following presents general characteristics of today's share class conversions, especially in the context of B shares:

- *Fund documents establish the framework for conversion*: The prospectus and SAI state whether and under what conditions a conversion is permissible. They identify whether automatic (scheduled), ad hoc, or other conversions are supported, and may denote where shareholder experience could be different based on the operational capabilities and data available to the entity servicing the shareholder.
- *The length of share retention by the shareholder is important*: Conversion is often predicated upon fulfilling a commitment to retain shares in a share class for a specified time. For example, B shares acquired by purchase must be free of CDSC liability, as specified in the prospectus, before shares are eligible for conversion. In the case of C shares, there are a number of factors determining a C share retention period and conversion time frame, including shareholder and fund fees and expenses incurred over time. The age of shares is often determined through use of share lots (discussed below).
- *When conversion occurs may or may not be explicitly stated*: As previously noted, the fund prospectus identifies whether automatic (scheduled) or ad hoc conversions are required or permitted. However, even scheduled conversions could occur on different dates[9] between funds and various intermediaries if the fund's prospectus and its operating policies allow for such variability.

[8] B shares (Class B shares) are subject to a declining CDSC over an extended period (often up to seven years). Once the shares are no longer liable for a CDSC, they are often automatically converted into a designated share class with a lower 12b-1 fee.

[9] When conversion frequency (e.g., monthly) is specified in a prospectus, it must be adhered to, even if the actual date of conversion varies.

Share Age—A Key to Conversion

As noted previously, the age of shares is typically a critical factor, as retention requirements within the C-share structure must be met before shares are eligible for a conversion. Examining transaction history and share lots can help determine the age of the shares.

TRANSACTION HISTORY HAS NUMEROUS LIMITATIONS

As investors buy, sell, exchange, and earn dividends on their C shares, it creates a transaction history within the account. Therefore, it is logical to think that a mutual fund's account history should be sufficient to derive the acquisition date for account shares. However, transaction activity or archiving of account history can cause such history to lose its effectiveness to determine accurate share aging.

» Account activity can cause acquisition dates to be lost. For example, when shares acquired are exchanged into another portfolio within the share class, the original acquisition date associated with the purchase of shares is lost, having been replaced by the exchanged-in date. Attempts to determine share age by adjusting account history for exchange activity across accounts, the impact of redemptions, and reinvested dividends is difficult and is not scalable across large numbers of shareholder positions.

» Transaction history is only retained in an active state, such as in an online database linked to the recordkeeping system, for a relatively short time. Though transaction history may remain available through secondary means (e.g., an archived database or other electronic storage), it is often not readily available for use when determining the age of shares.

Because of these limitations, the industry has turned to using share lots as the primary mechanism to achieve successful share class conversions.

ADVANTAGES OF SHARE LOTS

To avoid the problems with transaction history, mutual funds have typically employed share lots (lots) to track acquisition date and share age, when needed, for fee purposes.[10] Recordkeeping systems that support fee lots have a series of rules governing when and for what purpose lots are created, and how they are updated based on account activity. The following describes some of the common characteristics of lots that are beneficial to determining share age:

» Lots are typically created whenever shares are acquired through purchase, including capturing and retaining the creation date.

» Lots created by exchange from another portfolio in the class can carry over initial creation dates from the source portfolio to ensure aging continues as permitted by rules and by the fund's prospectus.

» In some instances, "dividend lots" are created through dividend reinvestment, to allow for special treatment (e.g., aging, CDSC, fee liability).

[10] Among the reasons that systems track lots are CDSC liability, application of age-based short-term redemption fees (related to SEC Rule 22c-2), and tracking of 12b-1 fees that vary based on acquisition date or share age.

- As shares are sold or exchanged out, lot balances are decremented—typically in a “first-in, first-out” (FIFO) order.
- Lots permit partial conversion of a shareholder’s total position by only moving those share lots that have met the conversion eligibility age.
- Lots are not archived unless fully depleted and no longer needed.

There are limitations and other factors to consider when using lot data to determine share age and, therefore, conversion eligibility:

- In most instances, lot tracking is not automatic.[11] It must be enabled when share age is needed to meet an operational need. When the need for lot tracking has ended (expired), most systems move expired lots into a “free share” category that retains no information about share age.
- Lot data within a recordkeeping system may be comprehensive, but lots with accurate aging information may still not be available for various reasons:
  - *Transfers:* When a customer’s shares are transferred between servicing entities, such as between broker-dealers or between a broker-dealer and the mutual fund, the delivering firm (which will no longer service the customer) typically also will transfer any related lots. If not received, funds and intermediaries have policies on how the receiving firm should treat the shares (e.g., create a “null” lot that has no acquisition date, create a “default” lot with a specified acquisition date or the transfer date, move transferred shares to free shares).
  - *Recordkeeper conversions:* When funds and intermediaries change recordkeeping systems (e.g., systems used by transfer agents, subaccounting agents, bank/trust departments, or retirement recordkeepers), share lots are often only converted as needed. Additionally, lots that cannot be accurately converted may be defaulted into null lot, free shares, or some other lot type agreed to by the counterparties, but that may reflect an incorrect or assumed age.
  - *Mergers:* Some task force members indicated that fund mergers into C-share classes also required creation of default lot types when the source fund did not track share lots. Often, the merger date was treated as the default acquisition/age date.
- Some types of intermediary systems, most notably in the retirement recordkeeping space, were not constructed to create or track fee lots.

[11] Many systems do not enable lot tracking when operational need does not exist, to save system processing resources, improve processing speed, and avoid unnecessary lot-to-account reconciliation.

Communicating Share Lots Between Recordkeeping Entities

Available lots can be transferred between firms via the National Securities Clearing Corporation (NSCC) Networking Share Aging service provided by the Depository Trust and Clearance Corporation (DTCC),[12] ensuring the original lot creation/share acquisition date is not lost when changing a shareholder's servicing arrangements (e.g., between intermediaries, or between an intermediary and fund company). The lot data shared, whether through NSCC or other means, should cover aging for fee purposes (e.g., CDSC, 12b-1 aging) as well as age-based share conversion tracking (e.g., C-share conversions), as applicable. Counterparties that do not use NSCC and that undertake a mass conversion of business that does not use NSCC should also provide any available lot information as part of ad hoc conversion files.

What About Tax Lots?

Since 2012, funds and intermediaries have been required to track and annually report a shareholder's adjusted cost basis.[13] This is almost always completed through a single-purpose tax lot structure that can accommodate adjustments due to various corporate action events such as a return of capital.

Some have suggested that tax lots can be treated as synonymous with fee-related share lots in the context of C-share conversion aging. Unfortunately, there are many challenges to using tax lots this way:

- The law passed by Congress considers shares owned prior to 2012 "non-covered" for cost basis reporting by the broker[14] to the shareholder; these shares are often held in a single lot—like the "free lot" concept for fee lots—that does not have the requisite share age.
- Retirement accounts like individual retirement accounts (IRAs) and 401(k)s are not required to maintain tax lots, because they do not report capital gains or losses.
- Tax lots are typically decremented to minimize the shareholder's tax objectives (e.g., based on the cost of shares). Sometimes this is in FIFO order, but often it is by one of many specific lot identification methods that are not compatible with age-based decrementing required for C shares.
- Tax lots do not track CDSC eligibility, an important component of C shares.

For these reasons, tax lots—in most instances—are not useful/usable for C-share conversions.

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[12] The Depository Trust and Clearance Corporation's wholly owned subsidiary, the National Securities Clearing Corporation, offers its Networking service that includes the ability to exchange lot details through its share aging file, associating lot information with a transfer of shares between financial intermediaries, or between intermediaries and fund companies as investor servicing arrangements change. For additional details, see "Share Aging Best Practices," available at https://dtcclearning.com/products-and-services/mutual-fund-services/networking/networking-best-practices.html.

[13] The "Emergency Economic Stabilization Act," passed on October 3, 2008, required "financial intermediaries" (including funds) to report adjusted cost basis on taxable mutual fund shares acquired after January 1, 2012, to investors and the Internal Revenue Service.

[14] A tax reporting "broker" is the party responsible for information reporting to a shareholder, and, therefore, can refer to either a broker-dealer or mutual fund company.

C-Share Conversions Have Challenges

With this backdrop, it is easy to understand the many operational challenges surrounding C-share conversions:

- Because C shares typically did not incorporate a conversion option at inception,[15] instituting a conversion requirement now can be a very complex endeavor. Funds will need to understand both their operational capabilities and those of their counterparties as they consider policy and fund document updates as well as contemplate timelines for conversion during an evaluation and (possible) implementation.
- Data to evaluate share aging may not be readily available. Enabling fee lot tracking, while helpful prospectively, will not necessarily help in evaluating currently held positions, nor will it help distribution partners that do not have the means to easily determine share age (either prospectively or retrospectively).
- B-share conversions have evolved over many years to their current state but were predicated on having accurate and essentially complete fee lot data until time of share conversion. So, a B-share conversion model may provide a framework to follow for C-share conversions, but it most likely will need some modifications in practice.

Considering whether to institute a C-share conversion is a complex and multifaceted decision. The next section highlights some of these considerations.

To Convert or Not to Convert

The decision to modify or implement C-share conversions is unique to each fund family and is made independently as the fund considers a variety of internal and external factors.

Fund Board Involvement

The decision to offer C-share conversions ultimately resides with the fund's management and board of directors. Fund management generally will provide the board with a proposed policy for addressing share class conversions. Management will consider many different factors when developing its policy proposal. Critical factors and data points may include but are not limited to the following:

- Estimated number of current shares/shareholders affected if amended policies are adopted
  - Shares/shareholders eligible to convert at key conversion points (e.g., initial conversion, monthly/quarterly/semiannually/annually)
  - Shares/shareholders that likely will not be able to convert based on the amended policies (e.g., ineligible because an intermediary may not hold required lot information)

[15] Based on current ICI information, the first identifiable C-share class still in operation was created in 1996.

- Operational capabilities to determine share age and convert shares
    - Fund transfer agent
    - Intermediary recordkeepers
- Comparative analysis of hypothetical fees paid by shareholders in available fund share classes for shares held/retained for various periods of time
- Any contractual (e.g., selling agreement) conflicts created as a result of a potential policy change
- Communication plan for intermediaries, affected service providers, and direct shareholders—if needed—should the board approve a share class conversion policy

When presenting a share class conversion policy for consideration, management's preparation might vary if presenting an entirely new versus an amended share class conversion policy. For example, a new policy presentation might benefit from additional board education on general share class conversion principles to help the board make an informed decision. Regardless, any new or amended policy approved by the board most likely would require management to file amended fund documents with the SEC and initiate an implementation plan.

C-SHARE CONVERSION IS NOT MENTIONED WITHIN FUND DOCUMENTS

Funds that do not reference C-share conversion capabilities within their fund documents will not be able to offer the feature to shareholders without first adopting a policy that permits share class conversions and then filing amended fund documents.

C-SHARE CONVERSION IS ALLOWED (BUT NOT REQUIRED)

In this instance, a fund's share class conversion policy already exists. Some funds may permit C-share conversions to be completed at the request of the shareholder or by the intermediary as agent. Fund documents may specify basic eligibility criteria that may need to be met before conversion can be considered. Often, the prospectus may indicate the general steps for shareholders or intermediaries as agents to follow to request an ad hoc C-share conversion from the fund. For instance, NSCC supports ad hoc share class conversions through the cross-class exchange capabilities found within Fund/SERV®[16] (and described later in this paper). The existing policy may require amendment, however, if the intent is to institute an automatic conversion of shares held for a certain period.

[16] Fund/SERV® allows for the processing and settling of mutual fund transactions between asset managers and intermediaries. See www.dtcc.com/wealth-management-services/mutual-fund-services/fund-serv for more details. Customers of NSCC may review the best practices prepared for voluntary share class conversions at www.dtcclearning.com or www.dtcc.com/wealth-management-services/mutual-fund-services/mutual-funds-client-documentation.

AUTOMATIC C-SHARE CONVERSION IS STATED IN FUND DOCUMENTS

If the fund adopts an automatic C-share conversion for shares held for a certain period, fund documents and share class conversion policies will typically incorporate many, if not all, of the following attributes:

- The criteria used to determine shares eligible for conversion
  - How shares were acquired (e.g., through purchase and dividend reinvestment)
  - Current share characteristics (e.g., free from CDSC liability)
  - The age of shares and how calculated (e.g., X years from date of initial purchase)
- The destination share class (e.g., Class A)
- A specified frequency for conversion, including any allowance for flexibility within the period (e.g., no later than the last day of the period [monthly, quarterly, annually] after share eligibility for conversion has been met)
- Any clarifying language regarding shares held through intermediaries, including any parameters on conversion eligibility (e.g., requirements that participant level share lot aging be used to determine conversion eligibility)
- Confirmation that the conversion does not constitute a taxable event for federal tax purposes

When a fund's policies and registration statement provide for automatic C-share conversion, the fund, as well as any intermediary that qualifies under the language found in fund documents, must take steps to comply with the stated policy. Funds should work with their distribution counterparties to make sure each understands and can comply with the expectations. Compliance is often more effectively accomplished by identifying and considering the intermediary's capabilities when constructing and presenting new or modified C-share conversion policies for board consideration, as well as the language used in amended fund documents filed with the SEC. Intermediaries that cannot comply with the stated language may have to liquidate shareholders from the fund. Liquidation could result in a taxable event for the shareholder and, ultimately, could adversely affect the investor experience.

Intermediary Involvement

Intermediaries have the additional challenge of implementing multiple—often different—policies and procedures across their fund offerings, including those involving C-share compensation and potential C-share conversion practices. Recently, some intermediaries have approached fund counterparties to explore new or modified C-share conversion capabilities that help the intermediary adopt more uniform practices when managing C shares.[17] In some instances, funds indicate that they have approved specific updates to fund documents that assist the intermediary by describing their share class conversion programs and policies.

Regardless of who initiates consideration of new or modified C-share conversion policies, it is the board's approval of a share class conversion policy and subsequent SEC fund document supplement filing that initiates a countdown to when those policies are effective.[18] During that time frame, the fund, its transfer agent, and the intermediaries affected by the policy change initiate and execute their implementation plans. Details include the following:

- communicating to affected parties (e.g., fund shareholders, intermediaries),
- identifying eligible accounts and shareholders,
- clarifying operational requirements when evaluating and potentially converting shares (e.g., lot types),
- processing exceptions (e.g., transactions in error, transaction and compensation reconciliation issues), and
- coordinating general intermediary issues.

[17] Joe Morris, "Morgan Stanley Preps for Massive Fund Share Class Conversion," Ignites, April 2, 2018.

[18] The SEC generally has up to 60 days to optionally comment on any post-effective amendment to a registration statement that includes material changes. Any comments may need to be addressed by the fund and could delay the effective date of the registration statement amendment.

Communicating a C-Share Conversion

Clear and effective communication with affected counterparties is critical to successfully implementing or modifying a C-share conversion.

Lead Time Needed

Though some task force members have stated that modifications to existing C-share conversion capabilities can often be adopted within the 60-day notification window represented by the SEC 485(a) filing of an amendment to the fund's registration statement, many state that new C-share conversion capabilities can take up to 180 days to implement. As implementation complexity grows, the lead time extends. Other factors that can contribute to timing decisions include the following:

- The number of affected parties, including fund shareholders and intermediaries. Complexity increases as the number and types of parties to notify and/or coordinate increase.
- The availability and overall quality of lot data to identify shares eligible for conversion—significant gaps in share lot availability or quality (e.g., number of free, default, or null lots) may require additional time to improve upon either or both factors before an initial conversion.
- The ability of intermediary systems to match fund expectations about how to evaluate and treat various lot types (e.g., purchase vs. reinvested dividend lots). If a fund's approach to converting certain lot types is different than options already supported in the industry, additional time may be needed by intermediaries to accommodate or to propose an acceptable alternative to the fund.
- The fund's desired communication plan.
- The board's involvement during a C-share conversion implementation period—any board approval of operating policies or any other actions requiring board notifications, updates, or approvals must synchronize with the board's meeting schedule.

Regardless of the lead time required, task force members recommended using a multifaceted, matrixed communications strategy to convey the policy change, key operational expectations, and corresponding implementation date. Through a combination of fund document updates, email "blast" communications, and phone calls/meetings between fund operations and intermediary distribution personnel, all parties can move quickly toward evaluating and implementing the new or amended C-share conversion policy.

Communication with Shareholders

While shareholders will be notified of new or updated C-share conversion policies through amended fund documents, some funds and intermediaries on the task force also pursued additional communications of a new or amended policy. The following outlines both the factors considered, as well as actions taken, by task force members:

- The servicing arrangement for shareholders often affects if, when, and by whom additional communication may occur.
  - Shareholders whose accounts are serviced by the fund company (direct-at-fund shareholders) often received any combination of a letter or a statement message or insert describing the C-share conversion. The timing of the communication often dictated the communication method, as letters were typically used only for pre-conversion communications. Conversely, conversion transaction confirmations often included statement messages or inserts.
  - Intermediary back-office organizations often did not directly notify shareholders via written correspondence. Instead, their communications about amended C-share conversion policies were primarily to their financial representatives and advisers that support mutual fund shareholders. Some intermediaries sought assistance from the fund when developing their communications—whether to internal staff or to shareholders.
- Communication encompassed both full conversion (e.g., all shares moved with the initial conversion) and partial conversion (e.g., a portion of shares remained in the C-share account, thereby creating two positions for the shareholder).
- Some funds also incorporated announcements into websites and/or online account access tools for affected shareholders that highlighted an impending C-share conversion.
- Transaction confirmations and annual statements often incorporated unique C-share conversion transaction descriptions.

Redacted examples of fund documents and communications to shareholders and intermediary staff are provided in the appendix.

Communication Within Funds

There is a natural tendency to focus on communication with the fund's transfer agent and intermediary servicing teams, as those groups are most actively involved in the implementation and ongoing execution of C-share conversion activities. However, task force members strongly recommend meeting with sales teams—internal and external wholesalers—prior to communicating C-share conversion plans with intermediaries, and throughout the C-share conversion implementation process. Sales team members are often the first to receive questions about C-share conversion timelines, share eligibility, and changes to compensation received by financial advisers, so it is helpful that they are both aware of plans and their operational contact when questions arise. Some members also suggested reviewing the new policy and its implementation with the fund's chief compliance officer (CCO).

Communication with Intermediaries

In addition to the important communication with shareholders, funds should consider alerting their intermediary counterparties to any amended C-share conversion policies. This is especially true for intermediaries who subaccount fund shares on behalf of shareholders—such as certain broker-dealers, retirement plan recordkeepers, and bank/trust companies.[19] Not only might these intermediaries need to communicate to shareholders, as previously described, but they also have additional operational and technological considerations to address.

APPLICABILITY TO FUND SHAREHOLDERS SERVICED BY THE INTERMEDIARY

Intermediaries will review the amended policies for applicability to their specific situation. For instance, an intermediary that cannot fulfill a fund's stated lot eligibility requirement (because they do not track share lots, for instance) may find it cannot provide C-share conversion capabilities to the shareholders it supports. This is sometimes the case with retirement plan recordkeeping systems, for example. If, however, the intermediary meets the eligibility criteria of the amended policy, and the policy requires action to be taken, the policy is applied to all eligible shareholders.

TIMELINE TO FIRST CONVERSION

If applicable, the fund's amended policy will require the intermediary to undertake many of the same steps as the fund and its transfer agent, including the following:

- Identifying eligible shares/shareholders
- Notifying key constituencies (e.g., shareholders, financial advisers)
- Establishing the technical framework to facilitate conversion
- Preparing or adapting conversion balancing and post-conversion reconciliation policies and procedures

For these reasons, it is critical that intermediaries understand when they must be ready to act on amended C-share conversion policies.

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[19] In a subaccounting arrangement, the intermediary handles all communications and servicing of underlying shareholder accounts on its own recordkeeping system (or that of its service provider) and reports share transactions to the funds on an aggregate basis. The fund's transfer agent holds the aggregate (omnibus) account in the name of the intermediary. As a result, the underlying shareholders in an omnibus account do not directly interact with the fund organization.

Fund members of the task force indicated that, when possible, they attempted to provide flexibility to intermediaries when implementing the amended policy. For example, while fund policy may establish the conversion frequency (e.g., monthly) that an intermediary must follow, the policy may not specify the day or date within the period when the conversion must occur. This can be helpful for intermediaries as they attempt to standardize the execution of conversions across multiple fund families—thereby reducing operating risk and streamlining shareholder servicing. As previously mentioned, some intermediaries have worked with funds to accommodate the intermediary's share class conversion policy through amended fund documents or appendices.

System and Operational Considerations

Intermediaries and funds will need to discuss system and operational capabilities and considerations that will ensure fair treatment across all shareholders of fund shares for which a C-share conversion is required and/or available. The following outlines certain questions that will need to be asked and capabilities clarified between funds and intermediaries:

1. **How should dates be used to determine eligibility?** As previously stated, eligibility for conversion is typically determined based on the age of fund shares. However, there are numerous ways to determine the age of a share, which may determine when it is eligible for conversion.
    a. *Lot anniversary* eligibility may require that the lot's age, as determined by month, day, and year, exceed the retention period before conversion can occur.
    b. *Monthly date* eligibility may require that the lot's age, as determined by month and year, meet or exceed the retention period before conversion can occur.
    c. *Specific day* eligibility may require that the lot's age, as determined by month, day, and year, must exceed the retention period before a specific day of the week (e.g., Sunday through Saturday) prior to scheduled conversion.
    d. *Specific week* eligibility may require that the lot's age, as determined by month, day, and year, must exceed the retention period before a specific week (e.g., the third full week of the month) prior to scheduled conversion.

The following example illustrates how each of these alternatives could affect share eligibility for a May 2018, C-share conversion:

Share lot creation date: May 27, 2008 (10 years old on Sunday, May 27, 2018)
Retention period: 10 years
Monthly C-share conversion completed: Fourth Tuesday of the month (May 29, 2018)

Eligibility	Conversion Month/Year	Reason
Lot anniversary	May 2018	The lot is 10 years old on May 27, 2018, so it converts.
Monthly date	May or June 2018	If the rule requires months to match, then conversion happens in May; otherwise it happens in June.
Specific day	May or June 2018	If the rule requires the lot anniversary to be reached on a Sunday or Monday before conversion, then conversion happens in May; otherwise, it happens in June.
Specific week	May or June 2018	If the rule requires the lot anniversary to be reached prior to the fourth week of the month, then conversion happens in June; otherwise, it happens in May.

It is important for funds to make sure that intermediaries understand both the date and date evaluation method to use to determine lot eligibility for C-share conversion.

2. **How should lots representing reinvested dividends be treated?** Lots created by dividend reinvestment are typically treated in one of four ways:

   a. *Aged-based on the date paid*: In this instance, the share lot is treated like any purchase lot. Aging starts based on the date the shares were reinvested into the shareholder's account.

   b. *Treated as free shares*: All dividend reinvestment shares are considered "free" or conversion-eligible upon posting to the account. They would convert during the next scheduled conversion event.

   c. *Based on the lot earning the dividend*: This treatment is based on the notion that the reinvested dividends result from a previous share acquisition, and dividend aging date should align accordingly.

   d. *Proportionally converted based on converting shares*: In this option, reinvested dividend lot shares are not linked to the original shares but are held in a separate unit (lot, bucket, etc.). The same percentage of dividend shares converts as the percent of non-dividend shares included in a conversion event. The lot may or may not have the same aging date as the share acquisition lot on which the dividends were earned.

3. **How should "incomplete" lot data be addressed?** What are the available options when all lots may not be available (e.g., due to transfer from another party, through system conversion or merger)? Options evaluated by task force members include the following:

   a. *Treat as free shares*: Though not common, under limited circumstances, shares could be considered free and would convert during the next scheduled conversion event. This option may be most likely considered for shares held upon occurrence of a past event (e.g., system conversion), at the point of initial C-share conversion, or for shares already held in an account when lot tracking is initiated.

   b. *Use transaction history or tax lot history to construct lots*: This option, while not commonly pursued due to the reasons previously identified, may be appropriate in certain limited circumstances. In most instances, however, use of history or tax lots will most likely require a significant systems development project. Depending on the source data used, extensive data mapping may be required between disparate systems and/or unfamiliar data structures (e.g., if the source data is from a previous system), which would make this option untenable.

   c. *Default-dated or null lots may be treated differently*: Many lot-based systems ensure that the account's outstanding shares are in balance with the account's shares held in lots. When sufficient lot shares are not found, the system creates default-dated or null-date lots with shares to create a balance between the lot shares and the account's shares outstanding. If an out-of-balance situation is created by an inbound transfer from another party (e.g., an Automated Customer Account Transfer Service [ACATS] transfer between broker-dealers), the default or null lots would be updated or replaced with any transferred-in lots received from the delivering party.

      If lots are not received from the delivering party, the aging date for C-share conversion purposes should, at minimum, be permissible based on the creation date of the default-dated or null-date lot. Some members of the task force also indicate that some systems may change default or null dates based on subsequent account and/or C-share conversion activity occurring on an account; this impact should be considered.

   d. *Shares are not immediately eligible for conversion*: Depending upon amended fund documents or the fund's operational policies, these shares may need to be retained in the C-share account until redeemed by the customer. Alternatively, if the shares can be prospectively tracked in a lot, one lot could be created and converted following the policy stated in fund documents.

4. **What other operational considerations may exist?** Beyond the larger eligibility issues that exist primarily due to the inability to track lot age, there could be additional challenges and considerations for intermediaries when complying with a fund's C-share conversion policy. The following were mentioned by task force members:

   a. *Timing of ongoing conversion events*: The systems supporting intermediary recordkeeping sometimes require an intermediary supporting both B- and C- share classes within the same fund family to complete them on the same schedule (day/date and frequency). As previously mentioned, funds often frame their conversion policy to provide intermediaries with flexibility to select the date of conversion to comply with conversion frequency.

   b. *Impact of market closure on specified conversion schedules*: In the event that a fund's policy specifies conversion on a specific date, parties should confirm how weekends, holidays, or unexpected market closures may affect the specific period's conversion date.

Eligible Shareholder Accounts and Conversion Shares

Once the lot management and conversion timing details are decided, it is necessary to identify the shareholders who are initially eligible for C-share conversion as well as their conversion-eligible shares. Many task force members cite applying the conversion logic to accounts and lots to create "hypothetical" pre-conversion reporting. Such an approach approximates what might occur during the actual conversion event and allows both funds and intermediaries to review results and research and resolve anomalies in the account and share selection process. Resolution could be at the account or lot level or through modification of the conversion event rules.

Often, the hypothetical reports repurpose existing B-share conversion reporting by fund transfer agents or intermediary subaccounting providers on behalf of their clients. The reports typically include attributes held on the record of the shareholder's account (C-share position) as well as the associated lot data.

Task force members indicated that the following information is often requested and/or provided on hypothetical pre-conversion reports; not surprisingly, these reports are often also generated when the actual C-share conversions occur:

» Summary reports commonly list the number of accounts affected, number of C shares sold and their corresponding dollar value on date of execution, and number of shares purchased in the destination share class.

» Detail reports often provide the account position detail associated with the summary reports, including shares sold and corresponding dollar value, as well as the number of shares purchased in the destination share class.[20]

[20] The corresponding purchase may occur into either a new or existing account position in the destination share class, depending on the availability of an existing position with matching attributes to the C-share account (e.g., account type, Social Security number, account registration).

When executing hypothetical pre-conversion reports, task force members shared the following considerations to help achieve a successful outcome:

- Establish rules and parameters for generating hypothetical reporting that match agreed-upon policies and use lot data as intended.
- Prior to executing the pre-conversion reporting event, confirm that account-level attributes are not set to *inadvertently*[21] exclude account types. Given that C-share conversion capabilities may be new to a fund and its accounts, it is possible that accounts were established without regard to the value of now-relevant attributes to a C-share conversion.
- Review results by focusing first on unexpected results, such as account or lot type inclusions that would have otherwise been expected to be excluded.
- Analyze the treatment of various lot categories like dividend, default-dated, or null-date lots to confirm that the conversion logic is being applied as expected.
- Identify various scenarios or combinations of circumstances that could affect accounts and evaluate them for the correct application of conversion logic. Scenarios or circumstances may include but are not limited to accounts affected by previous system conversions, transfers, or corporate action events (e.g., stock or reverse stock split, fund merger, etc.).
- Compare hypothetical conversion inclusion results with a listing of excluded accounts, to ensure that they were not excluded from conversion in error.
- When implementing a new C-share conversion, some additional considerations may be necessary:
  - Funds may determine that they need to review the reports from hypothetical conversions completed by key intermediary partners. As such, this activity will need to be coordinated and results reviewed with the intermediary prior to any live conversion.
  - Hypothetical pre-conversion reports may need to be created more than one time to reflect changes due to account and lot analysis, updates to conversion rules and parameters, etc.

[21] In some instances, systems may permit the ability to override or exempt an account from conversion analysis through intentional use of account attribute(s).

Conversion and Post-Conversion Considerations

A C-share conversion event typically includes the previously described reporting as well as corresponding transactions processed to update account positions, share balances, and corresponding share lots. The recordkeeping system updates create additional considerations for funds and intermediaries. Task force members identified the following areas where additional understanding is critical to achieve conversion success. While many of these situations are encountered only after the recordkeeping updates occur, both funds and intermediaries are urged to review expectations in these areas prior to the first (or next) C-share conversion:

Exchange Versus Sale/Purchase

It is important for funds and intermediaries to understand, prior to conversion, the transaction used to complete the C-share conversion. Most fund transfer agents process C-share conversions through a class-to-class exchange transaction.[22] Because both share classes involved in a C-share conversion are part of the same portfolio, exchanges can be ignored by the portfolio manager when assessing cash settlement needs.

From an intermediary perspective, conversion occurs through either an exchange or with two transactions: a sale of the C shares and with the proceeds used to separately purchase the destination share class. As exchanges are a transaction unique to mutual funds, intermediaries using other systems that were not built to support mutual funds may only have the sale/purchase transaction option available. The sale/purchase transaction combination may require the portfolio manager to free up cash to settle the sale proceeds while awaiting receipt of the same amount of cash to invest from settling the purchase transactions. This need may be mitigated if both transactions post and are settled on the same business day.

SALE AND PURCHASE THROUGH DCC&S

Intermediaries that use separate sale and purchase transactions in their fund omnibus accounts to facilitate the C-share conversion often do so through NSCC's Defined Contribution Clearance and Settlement (DCC&S) solution.[23] As stated previously, if both the sale and purchase transactions are included, the net impact to cash settlement obligations is zero. Failure of either side of the transaction creates a settlement imbalance for both parties and potential cash flow challenges. Those intermediaries using DCC&S to place the sale and purchase transactions in their omnibus accounts with the fund should follow the recommended practice and use asset type "G" (share class conversion) on their orders.[24] This will help the fund in reconciling the result of the C-share conversion event.

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[22] An exchange transaction is two-sided. In this instance, one transaction created by the C-share conversion event uses the proceeds from the dollars received from the sale of C shares to purchase shares at the net asset value price of the destination share class. Reference data typically link each side of the transaction, which helps with reconciliation.

[23] DCC&S permits intermediaries to receive valid investor instructions on trade date and transform them into mutual fund orders overnight for delivery through NSCC to fund companies early on trade date plus one (T+1). Such orders are included in each counterparty's net settlement obligations communicated on T+1. The solution is used for both non-taxable (retirement) and taxable (non-retirement) account types.

[24] See www.dtcclearning.com or www.dtcc.com/wealth-management-services/mutual-fund-services/mutual-funds-client-documentation/ for the Fund/SERV® record layouts (fixed or variable length) that describe the use of asset type indicators.

SHAREHOLDER TRANSACTION CONFIRMATION

Task force members indicate the use of a uniquely identifiable transaction that allows for customization on any transaction confirmation or statement mailed, or online transaction history displayed, to shareholders. As previously mentioned, some task force members incorporated messages on the statement or transaction confirmation or a separate insert with the documents explaining the nature of the transaction. Given that many C shares did not support conversions upon inception, and a buy-and-hold investor may have held their shares for an extensive period, such information could provide a helpful customer service to shareholders.

SUBACCOUNTING ACTIVITY AND POSITION REPORTING

Intermediaries that report underlying subaccount details to funds should include all C-share conversion transactions. Funds should make sure they understand how the intermediary will distinguish the reported conversion transaction activity—not only by type (either an exchange or sale and purchase combination) but also whether the intermediary will use unique transaction identifiers. Task force members report that this can vary based upon intermediary as well as the method used to communicate subaccounting activity. Likewise, intermediaries should also report new positions created in the destination share class and updates to the outstanding balance on existing positions in the C-share class.

Intermediaries often provide daily subaccounting activity on separate files or through portals used by the fund or a fund service provider for reporting sales activity to state governments (e.g., blue sky reporting). Because state blue sky laws vary, it is highly recommended that funds and intermediaries clarify how the intermediary should treat these transactions for blue sky purposes. Failure to correctly report or exempt transactions can create compliance issues for funds and unnecessary expenses for shareholders.

In-Flight, As-Of, and Trailing Dividend Transactions

Account activity may affect how a C-share conversion might process. Transaction examples with likely impact to a C-share conversion include the following:

- “In-flight” transactions refer to activity that, in some way, could affect the shares eligible for conversion. Examples may include a same-class exchange from another portfolio or a purchase placement that has not yet settled.
- As-of transactions reflect back-dated transactions (effective “as-of” an earlier date) that not only adjust available balances but also the aging date of shares. In funds that accrue dividends, an as-of transaction that applies to a prior dividend period can also affect dividend entitlements.
- Trailing dividends result in some instances where a transfer due to a servicing arrangement change (e.g., change of the shareholder’s broker-dealer) occurs around the time of a dividend payout. Sometimes, the current-period dividend earned on the transferred shares at the delivering firm may lag the transfer itself by one to three days for receipt by the receiving firm. It is possible that the date lag could cause a transfer and trailing dividend to fall into different C-share conversion events.

Fund and intermediary policies and procedures should address these exceptions. Decisions could increase or decrease shares eligible for C-share conversion during any given event—the decision could be that no adjustment to the shares converted will be made for anything that is "normal course of business;" however, adjustments will be made to correct for either intermediary or fund error. Funds must make sure that any decisions made do not conflict with fund disclosures or any fund policies approved by the board of directors.

Conversion Reversals

Intermediaries on the task force indicated that, in limited instances, there could be an account where a conversion reversal is necessary—moving shares back from the destination share class into Class C. Reasons cited related to misidentification of the account type that caused an otherwise ineligible account type to convert or to correct a conversion based on additional information made available to clarify lot and/or lot aging data.

Unlike the automatic C-share conversion, moving shares back into a C-share class after they have initially been deemed eligible to move into a (presumably) lower fee structure is not automatic and is subject to review. Likewise, system edits and other procedures may require exception (or at least different) processing to put shares back into a C-share account. For these reasons, funds and intermediaries may benefit from documenting and confirming both the approval process for a conversion reversal and the operational steps that would need to be followed to facilitate the activity.

Compensation Considerations

The C-share conversion will create an immediate change to compensation arrangements for intermediaries. Depending on the timing of the conversion, and how and when compensation is calculated, the impact could be difficult for an intermediary to quantify or explain to its affected representatives. This is especially true for the initial C-share conversion event, which will likely result in larger numbers of shares moving than in subsequent periods. Questions may emerge about conversion eligibility, ultimately down to the lot level. It may be beneficial, but certainly not necessary, for the initial C-share conversion to be scheduled to occur immediately following a compensation payment period.[25] Together, funds and intermediaries may identify various communication and other documentation practices unique to their counterparty relationship that could assist with this aspect of a C-share conversion implementation.

"Ad Hoc" C-Share Conversions

Even with an automated, scheduled C-share conversion policy in place, some fund documents may still permit conversion upon request of an intermediary on behalf of a shareholder. Additionally, reviewing the automated conversion results may identify additional eligible shares that should have moved but did not. When permissible, funds and intermediaries should discuss how on-demand or "ad hoc" C-share conversions can be requested and/or executed. Three common approaches to execute conversions are presented below.

[25] The primary consideration for scheduling C-share conversions is complying with fund prospectus and SAI guidelines regarding conversion timing.

VOLUNTARY SHARE CLASS CONVERSION

At the request of ICI BDAC, NSCC Fund/SERV® was modified to support an on-demand, voluntary cross-class exchange transaction, such as a C-share conversion. The transaction is especially useful for shareholder accounts held on the fund's transfer agent system yet intermediary-controlled (such as through NSCC Networking levels 0 [trust-networked], 3 [broker-controlled], or 4 [shared fund/broker control]). At the shareholder level, it avoids both tax reporting and cost basis effects caused by using separate sale and purchase transactions.

To use the transaction, intermediaries code the transaction type on their exchange record with either "C" (when a new account needs to be established in the destination fund) or "D" (when the destination fund account already exists). Customers of NSCC may review examples of best practices for voluntary share class conversions on the DTCC website.[26]

SEPARATE SALE AND PURCHASE TRANSACTIONS—NSCC AND MANUAL

As with the main C-share conversion event, separate sale and purchase transactions may be the primary (or sole) option available to some intermediaries to facilitate an ad hoc conversion. Use of these transactions carries the same cash settlement risks to both funds and intermediaries. DCC&S users should code these ad hoc transactions in the same fashion as other share class conversions with asset type "G" (share class conversions).

In what should be very limited instances, intermediaries may deliver manual instructions to funds to manually process a C-share conversion transaction on accounts under intermediary control (as determined by NSCC Networking levels) or on a "direct at fund" (not NSCC networked) account where they are the associated intermediary. Should the fund consent to accepting and completing the manual transactions on behalf of the intermediary, the fund will follow its internal procedures and process the activity as either exchanges or sale and purchase transactions. Regardless of intermediary activities, funds may need to periodically process ad hoc C-share conversions for their "direct at fund" accounts, where the fund assumes tax reporting and cost basis obligations on behalf of the shareholder. In those instances, the use of any cross-class exchange functionality provided by the transfer agent system may automatically handle the tax reportability and corresponding cost basis impact in a way that separate sale and purchase transactions may not.

CONFIRMATION OF FUND ACTIVITY TO THE INTERMEDIARY—NETWORKING

For all C-share conversion transactions initiated through NSCC, funds that send NSCC Networking F55 activity records to intermediaries are instructed to code them with transaction type "22" (share class exchange). The coding applies to exchange, sale, and purchase transactions. All ad hoc conversion transactions processed manually by the fund on either an intermediary-controlled account or "direct-at-fund" account with associated intermediary should have corresponding F55 activity records coded with transaction type "35" (voluntary cross-class exchange).

[26] See www.dtcclearning.com or www.dtcc.com/wealth-management-services/mutual-fund-services/mutual-funds-client-documentation/ for Voluntary Share Class Conversions Best Practices.

Ongoing Oversight of C-Share Conversion Activities

Just as fund boards ultimately approve any share class conversion policy needed to permit C-share conversions, boards play an integral role in ongoing oversight of the fund policy. Members of the task force reported that, for those fund boards that permit C-share conversions, fund boards have requested that key C-share conversion metrics be incorporated into periodic reporting by management to the board—most notably the number of shares/shareholders eligible and converted by period. Boards may also want to include any new or amended C-share conversion policies as part of their periodic reviews. Boards may rely upon input from their funds' CCO to help with their oversight of compliance with fund policies.

Intermediaries should be prepared to describe their C-share policies and procedures with funds, as part of the funds' oversight responsibilities. Those intermediaries that complete an annual Financial Intermediaries Controls and Compliance Assessment (FICCA) should include C-share conversions as part of their testing of related controls/control objectives.[27]

Conclusion

As fund distribution continues to evolve, funds and intermediaries will continue to evaluate mutual fund products and features to optimize their ability to support shareholders and their investment objectives. There are many operational challenges posed by retroactively implementing a C-share conversion into an established fund. Fund management evaluates and understands the operational capabilities of fund and intermediary recordkeepers, analyzes the availability and quality of data held by all parties to know the age of shares, and assesses approaches to effectively communicate potential policy change to shareholders and intermediaries. By doing so, management can make a reasonable determination as to whether it should recommend a new or amended share class conversion policy for board consideration, and boards should have the information necessary to make an informed decision on behalf of all fund shareholders on how to proceed.

[27] The FICCA engagement is conducted by an independent accounting firm to assess the internal controls relating to specified activities the intermediary performs for its shareholder accounts. It is performed under the attestation standards of the American Institute of Certified Public Accountants (AICPA). See the published framework at www.ici.org for additional details.

Appendix

Members of the C-share task force provided sample communications used for fund documents, shareholder and intermediary communications of C-share conversion policies, guidelines, and requirements.[1] This appendix provides the text of the samples provided; the organization's name and specific identifying details have been removed to anonymize the information.

General Communications—Fund Document Samples

SAMPLE 1—PROSPECTUS AUTOMATIC

Conversion of Class C shares

Class C shares held for X years after purchase are eligible for automatic conversion into Class * shares of the same fund. Conversions of Class C shares into Class * shares will generally occur, on the NN day or next business day of each month (conversion date). If the Xth anniversary after a purchase of Class C shares falls on a conversion date, an investor's Class C shares will be converted on that date. If the Xth anniversary occurs between conversion dates, an investor's Class C shares will be converted on the next conversion date after such anniversary.

The automatic conversion of Class C to Class * shares will be on the basis of the NAV per share, without the imposition of any sales load, fee, or other charge. Class C shares of a fund acquired through a reinvestment of dividends will convert to Class * shares of the fund pro rata with Class C shares of that fund not acquired through dividend reinvestment. All such automatic conversions of Class C shares will constitute tax-free exchanges for federal income tax purposes.

For shareholders investing in Class C shares through retirement plans, omnibus accounts, and in certain other instances, the fund and its agents may not know how long a shareholder has held Class C shares for purposes of determining whether such Class C shares are eligible for automatic conversion into Class * shares. In these circumstances, the fund will not be able to automatically convert Class C shares into Class * shares as described above. To determine eligibility for conversion in these circumstances, it is the responsibility of the shareholder or their financial intermediary to notify the fund that the shareholder is eligible for the conversion of Class C shares to Class * shares, and the shareholder or their financial intermediary may be required to maintain and provide the fund with records that substantiate the holding period of Class C shares.

[1] Inclusion of these documents does not imply an endorsement of any specific policies or procedures regarding C-share conversion activities.

In addition, a financial intermediary may sponsor and/or control accounts, programs, or platforms that impose a different conversion schedule or eligibility requirements in regard to the conversion of Class C shares into Class * shares. In these cases, certain Class C shareholders may not be eligible to convert to Class * shares as described above. However, these Class C shareholders may be permitted to exchange their Class C shares for Class * shares pursuant to the terms of the financial intermediary's conversion policy. Financial intermediaries will be responsible for making such exchanges in those circumstances. Please consult with your financial intermediary if you have any questions regarding the conversion of Class C shares to Class * shares.

The first conversions of Class C shares into Class * shares as described above will take place on Month DD, CCYY.

SAMPLE 2A—PROSPECTUS

Effective Month DD, CCYY, Class C shares of each applicable fund will automatically convert to Class * shares after X years, provided that the fund or the financial intermediary through which a shareholder purchased Class C shares has records verifying that the Class C shares have been held for at least X years, and that Class * shares are available for purchase by residents in the shareholder's jurisdiction. Group retirement plan recordkeeping platforms of certain broker-dealer intermediaries who hold Class C shares with the fund in an omnibus account do not track participant-level share lot aging. These Class C shares would not satisfy the conditions for the conversion.

SAMPLE 2B—SAI (ACCOMPANIES THE PROSPECTUS LANGUAGE ABOVE)

Class C shares will automatically convert to Class * shares on or around the end of the month X years after the purchase date, provided that the fund or the financial intermediary through which a shareholder purchased Class C shares has records verifying that the Class C shares have been held for at least X years, and that Class * shares are available for purchase by residents in the shareholder's jurisdiction. Group retirement plan recordkeeping platforms of certain broker-dealer intermediaries who hold Class C shares with the fund in an omnibus account do not track participant level share lot aging. These Class C shares would not satisfy the conditions for the conversion. Class C shares acquired by exchanging Class C shares of another (fund company) fund will convert to Class * shares based on the time of the initial purchase. Any CDSC for such shares will be calculated using the schedule of the fund into or from which shares have been exchanged that would result in the highest CDSC applicable to such shares. Class C shares acquired through reinvestment of distributions will convert to Class * shares based on the date of the initial purchase to which such shares relate. For this purpose, Class C shares acquired through reinvestment of distributions will be attributed to particular purchases of Class C shares in accordance with such procedures as the trustees may determine from time to time. The conversion of Class C shares to Class * shares is subject to the conditions that such conversion will not constitute taxable events for federal tax purposes. Shareholders should consult with their tax advisers regarding the state and local tax consequences of the conversion of Class C shares to Class * shares, or any other exchange or conversion of shares.

SAMPLE 3—PROSPECTUS

In general, Class C shares, and any reinvested dividends and other distributions paid on such shares, automatically convert to Class * shares on a monthly basis, X years after the end of the month in which the shares were purchased. However, Class C shares that have been held for fewer than X years also will convert to Class * shares if (i) the Class C shares are not subject to a CDSC, and (ii) a commission was not paid on the sale of such shares. All conversions from Class C shares to Class * shares will be on the basis of the relative NAVs per share, without the imposition of any sales load, fee, or other charge. The conversion from Class C shares to Class * shares is not considered a taxable event for federal income tax purposes. For investors invested in Class C shares through a financial intermediary, it is the responsibility of the financial intermediary to ensure that the investor is credited with the proper holding period for the shares redeemed. The automatic conversion of Class C shares to Class * shares shall not apply to shares held through intermediaries that do not track the length of time that a participant has held such shares.

SAMPLE 4—PROSPECTUS (REGARDING INTERMEDIARY RESPONSIBILITIES)

Effective Month DD, CCYY, except as noted below, Class C shares will automatically convert to Class * shares after X years. For Class C shares held through a financial intermediary, it is the financial intermediary's (and not the fund's) responsibility to ensure that the investor is credited with the proper holding period. Due to operational limitations at your financial intermediary, your ability to have your Class C shares automatically converted to Class * may be limited. For example, automatic conversion of Class C shares to Class * shares will not apply to fund shares held through group retirement plan recordkeeping platforms of certain broker-dealer intermediaries that hold such shares in an omnibus account and do not track participant-level share lot aging to facilitate such a conversion. Please consult your financial representative for more information.

SAMPLE 5—LETTER

Class C shares you purchased will begin converting to Class * shares X years after their purchase date, allowing you to take advantage of certain reduced fund expenses. The first automated conversion of all shares held X years is scheduled to take place in Month Year. The holding period for any remaining Class C shares will continue to be tracked separately and will convert monthly as they reach the X-year mark. Please see your fund's prospectus and SAI for details.

Important features:

- These conversions of shares are non-taxable events.
- These conversions of shares will be reflected on your quarterly statement. You may call us at the number and times below for a copy of your most recent statement activity.
- If you still have Class C shares in your account, any systematic withdrawal plans you have will remain in place on your original Class C account. However, because the value of the Class C account has been lowered due to this transaction, your account may be exhausted sooner than you had originally planned. Now would be a good time to review your account with your financial professional if you would like to arrange a systematic withdrawal plan on your Class C shares account and your Class * shares account simultaneously.

For more information, talk to your financial professional or call us at XXX-XXX-XXXX from X am to X pm (time zone).

SAMPLE 6—LETTER #2

Dear Valued Shareholder:

The Board of Trustees of the (fund complex) ("the funds") recently approved amending the registration statement of each of the funds. The amendments provide for conversion of Class C shares of each of the funds into Class * shares of the same funds once the holding period of the Class C shares exceeds X years. You are receiving this message because you currently hold Class C shares in one or more of the funds.

This conversion does not alter your individual investments or your investment strategy, or carry any fees. It is a simple change that reflects how the industry has moved to accommodate longer-term shareholders in individual funds, and we want to ensure we reflect industry standards.

The following briefly highlights important dates and information shareholders should note:

» The initial conversion of Class C shares to Class * shares will occur on Month DD, CCYY, and will include all Class C shares held for X years as of Month DD, CCYY.

» After that, conversions will occur within the first half of each month and will include shares that have reached the X-year holding period by the end of the prior month. For example, in Month CCYY, Class C shares that attained an X-year holding period prior to the end of (Month-1) CCYY will be converted to Class * shares.

» No commissions or sales charges will be assessed on these conversions to Class * shares and fund shareholders will not recognize a gain or loss for federal income tax purposes as a result of the conversions.

» The holding period is computed using the original acquisition date of each investment in Class C shares, and each conversion will include the proportionate amount of reinvested dividends and capital gains distributions earned by those shares.

The notice is for informational purposes, and no action is required of you. If you have questions, please contact your financial adviser or call our Contact Center at XXX-XXX-XXXX.

SAMPLE 7—STATEMENT INSERT

Important Information Regarding Your Account
Due to recent prospectus changes, your account in Class C shares, where (fund's internal distributor) is the broker of record, was converted to Class * shares. No sales charges or fees were assessed for the conversion of shares, and you will not be subject to any federal income tax as a result of the conversion.

Effective MM/DD/CCYY, all accounts invested in Class * shares, with (fund's internal distributor) as broker of record, are able to purchase Class * shares without a sales charge.

Please refer to the prospectus at (fund's url.com) for additional details.

Must be preceded or accompanied by a prospectus

SAMPLE 8—INTERMEDIARY BACK OFFICE

Effective the date of the attached supplement, (funds) has added an automatic conversion of Class C shares feature. Beginning Month DD, CCYY, Class C shares held for X years after purchase will be eligible for automatic conversion into Class * shares of the same fund.

Key Details Surrounding Monthly C to * Share Class Conversions

» Conversions of Class C shares to Class * shares will generally occur monthly on the NN day or next business day.

» The automatic conversion of Class C shares to Class * shares will be on the basis of the NAV per share, without the imposition of any sales load, fee, or other charge.

» All such automatic conversions of Class C shares will constitute tax-fee exchanges for federal income tax purposes.

» For shareholders investing in Class C shares through retirement plans, omnibus accounts, and in certain other instances, the fund and its agents may not know how long a shareholder has held Class C shares for purposes of determining whether such Class C shares are eligible for automatic conversion into Class * shares. In these circumstances, the fund will not be able to automatically convert Class C shares into Class * shares as described in the supplement; therefore, it will be the responsibility of the financial intermediary or shareholder to determine eligibility and initiate the conversion.

» In addition, a financial intermediary may sponsor and/or control accounts, programs, or platforms that implement a different conversion schedule or eligibility requirements in regard to the conversion of Class C shares into Class * shares. If your firm will be implementing a different conversion schedule than the fund's, please notify us at (email address).

» Details regarding conversions initiated by TAs (transfer agents) will be sent monthly via Networking, F55 activity record, on the next business day after the conversion.

» For further information regarding the automatic conversion of Class C shares to Class * shares, see the attached prospectus supplement.

Fund identifiers are included below: (includes fund name, share class, CUSIP, and NASDAQ symbol)

If you have any questions pertaining to this announcement, please call XXX-XXX-XXXX or email (email address).

SAMPLE 9—INTERMEDIARY BACK OFFICE

Automatic Conversion of Class C to Class * shares

On Month DD, CCYY, (funds) announced that the funds will begin automatically converting Class C shares to Class * shares after X years. Please see the attached copy of our previous communication dated Month DD, CCYY, for the initial announcement and prospectus/SAI disclosure language. Additional operational details are below:

Key dates and settings

- Conversions will take place on the NN day of the month, or the next business day thereafter, following the Xth anniversary of the trade date.
- The first conversion will take place on Month DD, CCYY, for all Class C shares that were purchased on or prior to Month DD, CCYY.

Definitions and share lot settings

- Shares resulting from a dividend reinvestment ("reinvested lots") will be converted in proportion to the purchase lot in the conversion transaction.
- Shares received via a transfer, where share lot aging was not provided, will default to a purchase date equal to the date of the transfer.
- Any other free share lots with no lot date assigned will convert to Class A on the first available conversion date.

Other operations/processing details

- An F55 Networking activity detail record with transaction type 22 (share class exchange) will be generated as applicable.

Exclusions/exceptions

- Matrix Level 3 omnibus accounts are excluded from (fund's) automated conversion. It is expected that intermediaries will perform the conversions in their customers' subaccounts.
- Because settings and capabilities vary between systems, our prospectus disclosure acknowledges that due to intermediary system limitations, a shareholder's ability to have their shares roll may be limited. Intermediaries are expected to make a "best efforts" attempt to apply the conversions as outlined above.
- If, due to a system limitation, an intermediary cannot support the automatic conversion, the intermediary must request account level exclusions by following these steps:
    1. Email the request to (email address).
    2. Include the transfer agent fund/account numbers for every individual account to be excluded.
    3. Affirm that reason for the exclusion is that the automated conversion cannot be supported via the intermediary's systems.
    4. Affirm that, in the future, it is the intermediary's responsibility to notify (funds) of any new or additional accounts that need to be added to the exclusion list or if any accounts can be removed from the exclusion list.

Adjustments

If any accounts need to be corrected after the conversion is processed, normal adjustment processing will be performed, including the requirement for indemnification from the intermediary for adjustment requests.

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1401 H Street, NW
Washington, DC 20005
202-326-5800
www.ici.org