



COMMISSIONER OF FINANCIAL INSTITUTIONS
GOVERNMENT OF PUERTO RICO

April 1, 1996

CIRCULAR LETTER - SECURITIES 1996-1

Advertising of Individual Retirement Accounts that Invest in Securities

Authority

This Circular Letter is issued pursuant to the provisions of Articles 10(a)(2) and 10(a)(8) of Act No. 4 of October 11, 1985, as amended; Article 101 of the Puerto Rico Uniform Securities Act, Act No. 60, of June 18, 1963, as amended, and Rules S-7 and S-9 of the Regulations of the Uniform Securities Act of Puerto Rico.

Definitions

For the purpose of this Circular Letter:

1. Commissioner - The Commissioner of Financial Institutions, as defined in Act No. 4, of October 11, 1985, as amended.
2. Advertising - Any material published or designed for use in newspapers, magazines or other periodicals, radio television, telephone, or tape recording, videotape display, signs or billboards, telephone directories, (other than routine listings) or other public means.
3. Sales Literature - Any written communication distributed or made generally available to customers or the public, which communication does not meet the definition of advertisement. Sales literature includes, but is not limited to, circulars, research reports, market letters, performance reports or summaries, form letters, seminar text, reprint or excerpts of any other advertising sales literature or published article.

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Advertising Format

1. All advertising will continue to be subject to final approval by the Commissioner of Financial Institutions and should be submitted to the Commissioner, 5 business days prior to use.
2. The smallest letters in the advertising should not be less than 10 points.



3. The advertising should contain all facts necessary in order to make the statements made therein not misleading. A clear disclaimer should be included to the effect that past performance does not guarantee future results.
4. The performance data in the advertising should meet the requirements of this Circular. A note should be included to the effect that the rate stated in the advertising is an historical one.
5. All yields quoted should include all trust fees and expenses.
6. Disclose in the advertising all expenses, fees, even when the trust is not charging them at the moment. Also, any subsidy of fees or expenses should be specified.
7. The fund will specify any policy concerning the use of borrowed money to leverage the funds asset base. If the fund is authorized to leverage its assets, it should clearly state that fact and address the effect of this potential leverage in relation to the degree of risk that such leverage implies for the shareholder.

Performance data

1. The performance data should be calculated as total return:
 - a) assume an initial investment of \$2,000 converted to a net asset value for 1 or more year periods ending on the date of the most recent balance sheet;
 - b) assume all dividends and distributions are reinvested on the reinvestment dates during the year, i.e., total return must reflect sales loads charged upon reinvestment of dividends;
 - c) reflect all sales loads and account fees, and if some of these loads and charges are not currently charged, explain under what circumstances they would be charged;
 - d) if the fund has been operating for less than one year, determine the return for the period that the fund has been in operation, do not annualize the result, and disclose the length of time that the fund has been operating in a note in the advertising;
 - e) all performance data shall be based on the past history of the specific fund being sold, and forecasts or projections of future performance are prohibited, and
 - f) the computation sheet should be submitted to the Commissioner.

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Total Return

1. Total return should be computed using the following formula:

$$TR = \left[\left(\sqrt[N]{\frac{(NAV_T)(S_T) - E_T}{I_0 + F_0}} \right) - 1 \right] \times 100$$

TR = Average annual percentage total return in a hypothetical \$2,000 initial investment, and the reinvestment of all distributions in accordance with the registration statement.

NAV_T = Net asset value per share at the end of the period T.

S_T = The number of fund shares owned at the end of period T.

I₀ = The initial investment by the investor which is assumed to be \$2,000.

F₀ = Any charges, fees or commissions paid on the initial investment (i.e., set up fee, sales fee, commissions, etc.) over and above the initial \$2,000 investment. (In the case of closed end IRA funds this would also include any premium paid on the initial investment over the net asset value per share of the fund.)

E_T = This term includes the sum of (1) any expenses or fees paid by the individual from sources other than the sale of shares in the IRA fund, beginning immediately after the initial purchase and ending upon the actual redemption, or the assumed redemption at the end of the period in question for the purposes of this calculation, plus, (2) any back end fee, sales charge on the sale of the fund shares or any commissions on the sale of shares of a closed end type IRA fund, plus (3) in the case of a closed end type IRA fund, any discount from the net asset value of fund shares when they are sold at redemption.

N = The number of periods for which the total return is being calculated. If N is expressed in periods of less than a year, i.e. month, then the monthly returns should be multiplied for the twelve months of the year to obtain an annual return, or, if the period is a quarter, then the four quarters' returns should be multiplied together to obtain the annual return.

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2. In regard to the computation, furnish the length of the time period and the last day of the period used in computing the quotation and a description of the method by which average total return is computed, and:
- a) Assume that the maximum sales load (or other charges deducted from payments) is deducted from the initial payment. If shareholders are charged a deferred sales load, assume the maximum deferred sales load is deducted at the times, in the amounts, and under the terms disclosed in the prospectus.
 - b) Assume all dividends and distributions by the fund are reinvested on the reinvestment dates during the period, i.e., total return must reflect any sales load charged upon reinvestment of dividends.
 - c) Include all fees that are charged to all shareholder accounts. For any account fees that vary with the size of the account, assume an account size equal to \$2,000 initial investment. If recurring fees charged to shareholder accounts are paid other than by redemption of fund shares, they should be appropriately reflected.
 - d) Determine the ending redemption value by assuming a complete redemption at the end of the period for which the total return is being calculated.
 - e) The time period for which the initial registration statement has been in effect should be the maximum length of the period under consideration for calculating the total rate of return.
 - f) Carry the total return quotation in the nearest hundredth of one percent.
 - g) In addition to the above, for "closed end" type of IRA funds the total return calculation must incorporate the effect of a purchase or a sale of the fund's shares at prices other than the net asset value of the fund's shares. Any such aggregate differential (i.e. reflecting the number of shares in the transaction), should be treated as an expense or a negative expense, as appropriate, for purposes of the calculation. This Office will take particular notice of either a consistent pattern of premiums from the net asset value of the fund's shares upon the acquisition of the shares or, on the other hand, a consistent pattern of discounts from the net asset value of the fund's shares upon the redemption and conversion into cash for the investor. If such a consistent pattern exists, such fact, along with the extent of such variation, should be specifically stated in the advertising material for the fund or investment vehicle. Closed end type IRA funds must also disclose the potential limitations upon the market for the fund's shares or a prospective sale by the investor. The ramifications of such a limited market should be explained in a manner, and at a level, that the average IRA investor can assess such risks properly.

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- h) The calculations should exclude the possibility of a penalty paid to the Government of Puerto Rico for a redemption of the fund shares prior to retirement as contained in the Puerto Rico Internal Revenue Code of 1994, as amended.
 - i) Closed end type IRA funds should indicate the availability of and the extent of the market for the sale of the fund's shares. If this market is limited in any manner, this fact must be adequately disclosed to the investor.
3. In addition to the calculation of Total Return, if a fund or investment vehicle wishes to calculate the rate of return for periods of two years or more, incorporating the annual IRA contribution of \$2,000 at one year intervals following the initial investment, it may do so, at its option, in the following manner:
- a) Determine the total rate of return for the first year of the period utilizing the following formula:

$$TR_1 = \frac{(\text{NAV}_1)(S_1) - E_1}{I_0 + F_0}$$

Where:

- TR_1 = The total return (in decimal form) for year one.
- S_1 = The number of fund shares held at the end of the first year, and, before the annual IRA contribution for the second year.
- E_1 = The fees and expenses, as defined in this Circular Letter, incurred by the investor during the first year.
- NAV_1 = The net asset value of the fund's shares at the end of the first year.
- I_0 = The initial investment by the investor which is assumed to be \$2,000.
- F_0 = Any charges, fees or commissions paid on the initial investment (i.e., set up fee, sales fee, commissions, etc.) over and above the initial \$2,000 investment. (In the case of closed end IRA funds this would also include any premium paid on the initial investment over the net asset value per share of the fund).

- b) Determine the total rate of return for the second year of the period recognizing the additional \$2,000 annual IRA contribution made at the beginning of the second year:


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$$TR_2 = \frac{(NAV_2)(S_2) - E_2}{(NAV_1)(S_1) + I_1 + F_1}$$

Where:

I_1 = The annual \$2,000 IRA contribution at the beginning of the second year.

E_2 = The sum of (1) any expenses or fees paid by the individual from sources other than the sale of shares in the IRA fund during the period in question (period 2) plus (2) any back end fee, sales charge on the sale of shares of a closed end type IRA fund (if this is the last period in the calculation), plus (3) in the case of a closed end type IRA fund, any discount from the net asset value of fund shares when sold at redemption (if this is the last period in the calculation).

F_1 = Any charges, fees or commissions paid by the investor on the additional \$2,000 IRA contribution at the end of the first year over and above the \$2,000 IRA investment itself.

c. For succeeding years the total rate of return is calculated individually, year by year. For the nth year of the period it is:

$$TR_N = \frac{(NAV_N)(S_N) - E_N}{(NAV_{N-1})(S_{N-1}) + I_{N-1} + F_{N-1}}$$

Where:

NAV_N = Net Asset value per share at the end of period N.

S_N = The number of fund shares held at the end of period N.

E_N = The fees and charges, as defined, incurred by the investor during the Nth year.

NAV_{N-1} = Net Asset value per share at the end of period N-1.

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S_{N-1} = The number of fund shares held at the end of period N-1, before the \$2,000 IRA contributor for the Nth year.

I_{N-1} = The annual IRA contribution at the beginning of the Nth year.

F_{N-1} = Any changes, fees or commissions paid on the annual IRA contribution made at the beginning of the Nth year, as defined herein.

- d. Once the total rate of return is calculated for each individual year, calculate the total return for the period as follows:

$$TR = 100 \left[\sqrt[N]{(TR_1)(TR_2)(TR_3) \dots (TR_N)} - 1 \right]$$

- e. The back load or exit fees, if applicable, are only incorporated into the analysis at the end of the nth year of the period, i.e., only charged once, at the end of the period under consideration.
- f. Any fund using this approach to the total return, must also utilize the total return for the single contribution IRA as calculated in paragraph one of this section.

Limitations

In the event that the total return calculated following the formulas provided herein exceeds 10 % per year, the advertising must include a warning that such a return in the past does not guaranty a continuation of such a return in the future.

All such advertisements, with this class of return, will be scrutinized very carefully by this Office to insure that the average IRA investor is made fully aware of the market and interest rate risk inherent in this type of investment. The advertising can not imply, directly or indirectly, that short term above market returns achieved in the past, will be the norm for the particular IRA fund in future years as well.

Full and complete disclosure will be the basic requirement enforced by this Office at all times.

Effectiveness

This Circular Letter will have immediate effectiveness

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Joseph P. O'Neill
Commissioner