

MEMO# 21378

July 20, 2007

ICI Comment Letter on Rule 12b-1

[21378]

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TO: BOARD OF GOVERNORS No. 19-07
BANK, TRUST AND RECORDKEEPER ADVISORY COMMITTEE No. 22-07
BROKER/DEALER ADVISORY COMMITTEE No. 38-07
OPERATIONS MEMBERS No. 12-07
SEC RULES MEMBERS No. 89-07
SMALL FUNDS MEMBERS No. 58-07
TAX MEMBERS No. 30-07
TECHNOLOGY ADVISORY COMMITTEE No. 22-07
TRANSFER AGENT ADVISORY COMMITTEE No. 43-07 RE: ICI COMMENT LETTER ON RULE 12b-1

On June 19, 2007, the Securities and Exchange Commission held a roundtable (“Roundtable”) on Rule 12b-1 under the Investment Company Act of 1940 that addressed the history of the rule, the current uses of 12b-1 fees, the costs and benefits of 12b-1 plans, and the potential options for reform or rescission of the rule. In connection with the press release announcing the panelists and final agenda for the Roundtable, the SEC encouraged all interested persons to comment on the topics discussed at the Roundtable and on any other issue relating to the use of fund assets to pay for the sale of fund shares. [\[1\]](#)

In response to this request, the Institute has filed a comment letter with the SEC. The letter supports the SEC’s review of Rule 12b-1, but urges the SEC to refrain from making changes that would fundamentally alter the way Rule 12b-1 operates or that would fully or partially rescind the rule. Instead, the letter states that any changes to Rule 12b-1 should be limited to those that refine or enhance the rule, such as changes that would clarify the role of the board under the rule and provide better disclosure of 12b-1 fees. The most significant aspects of the letter, which is attached, are summarized below.

The letter first discusses the importance of an economic analysis in rulemaking. It states that in reviewing Rule 12b-1, the SEC should identify the need for any changes and should assess the economic costs and benefits of any proposed changes and relevant alternatives. The letter notes that hasty or ill-designed changes to the rule risk confusing or displacing investors, disturbing the vast market for mutual funds, and impairing market efficiency and competition.

The letter next provides a brief overview of the importance of Rule 12b-1 to mutual funds and their shareholders, including information about the primary uses of 12b-1 fees. It notes that the regulatory history of Rule 12b-1 has been the subject of recent discussion by regulators, the media and industry participants. The letter then discusses changes to Rule 12b-1 that have been offered by various Roundtable participants and other commentators, including: (i) revisiting board oversight under Rule 12b-1; (ii) improving disclosure and transparency of 12b-1 fees; (iii) assessing 12b-1 fees on individual shareholder accounts rather than fund assets; and (iv) fully or partially rescinding Rule 12b-1.

With respect to the board's responsibilities in approving 12b-1 plans, the letter states that the SEC should consider modifying the role of directors to reflect current uses of 12b-1 fees, updating or eliminating the board factors originally suggested by the SEC, and/or eliminating Rule 12b-1's quarterly reporting requirements. To improve investor awareness and understanding of 12b-1 fees and other fund fees and expenses, the letter states that the SEC should consider improving the disclosure provided to investors both by the fund in its disclosure documents and by the intermediary at or before the point of sale.

The letter recommends against changes that would fundamentally alter the way Rule 12b-1 operates, such as requiring funds to assess 12b-1 fees directly from shareholder accounts rather than from fund assets, or that would fully or partially rescind the rule. In general, the letter notes that such changes would limit investor choices, increase barriers to entry to the industry, cause shareholders to pay higher taxes on their funds, and impose significant operational and transitional costs on funds, intermediaries, and investors.

Jane G. Heinrichs
Associate Counsel

[Attachment](#)

endnotes

[1] The press release can be found on the SEC's website at <http://sec.gov/news/press/2007/2007-112.htm>.

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