

MEMO# 21613

September 20, 2007

Remarks by Institute President on Rule 12b-1

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TO: BOARD OF GOVERNORS No. 22-07

CEOS

INVESTMENT COMPANY DIRECTORS No. 21-07

PRIMARY CONTACTS - MEMBER COMPLEX No. 22-07

SEC RULES MEMBERS No. 125-07

SMALL FUNDS MEMBERS No. 84-07 RE: REMARKS BY INSTITUTE PRESIDENT ON RULE 12b-1

Last week, Institute President and CEO Paul Stevens delivered a speech at a conference hosted by the American Enterprise Institute for Public Policy Research ("AEI") entitled "Should the SEC's Rule 12b-1 Survive?" The conference also featured a discussion of Rule 12b-1 with several expert panelists, including Barry Barbash, partner at Willkie Farr & Gallagher and former director of the Securities and Exchange Commission's Division of Investment Management; Mercer Bullard, founder and president of Fund Democracy; and Mary Bush, independent director at Pioneer Funds. Peter Wallison, senior fellow and co-director of AEI's program on financial market deregulation, moderated the conference. Mr. Stevens' remarks are briefly summarized below. [\[1\]](#)

Mr. Stevens began by commending the SEC for its review of Rule 12b-1, but cautioned that any review of the rule should include a rigorous analysis of the need for, nature of, and likely impact of any proposed changes. He explained that "Rule 12b-1 lets investors pay over time for the bundle of valuable services they receive, rather than doing so through sales charges at the time of purchase." He added that the costs that investors incur under Rule 12b-1 would not disappear if the rule did, as some critics have suggested. Instead, he said, "they simply would migrate elsewhere."

Next, Mr. Stevens described the dramatic decreases in overall mutual fund costs, including distribution costs, since Rule 12b-1 was adopted in 1980. He noted that it is not apparent that eliminating, or lowering the limit on, 12b-1 fees would produce further reductions in total distribution costs. To the contrary, externalizing distribution costs would compel

intermediaries to shift to a different – and likely higher cost – compensation model for the ongoing services they provide to many fund investors. He noted that these costs likely would be passed on to investors.

Mr. Stevens said that eliminating or further limiting 12b-1 fees would deprive investors of the flexibility of multiple share classes, including classes specifically designed to help investors meet their goals of saving for retirement and paying for college. He also noted that curtailing Rule 12b-1 would have a competitive impact on smaller fund complexes that are especially dependent on intermediaries to make their funds available to investors.

Mr. Stevens next questioned whether imposing 12b-1 fees at the shareholder account level would make the fees more transparent, as some critics contend. He stated that account-level fees would cause investors to incur higher tax costs and would complicate their tax compliance. He also noted the significant and costly operational implications of account-level fees.

Mr. Stevens then discussed ways to improve the disclosure of 12b-1 fees. He noted that the SEC is considering ways to improve overall fund disclosure by allowing funds to use a summary disclosure document with key information about a fund, like the “quick-start card” that comes with new consumer electronic products. Mr. Stevens said that an additional way to improve investor understanding of 12b-1 fees would be to require that financial intermediaries inform their customers directly about 12b-1 fees and other compensation they receive. He cautioned, however, that such a requirement should logically extend to other competing financial products so as to avoid establishing disincentives for intermediaries to offer funds to their customers.

Next, Mr. Stevens stated that because mutual fund investing has evolved dramatically since Rule 12b-1 was adopted, many independent fund directors and other commentators have urged the SEC to update its guidance to fund boards concerning their responsibilities under Rule 12b-1. Specifically, he highlighted two areas in need of reform: the “out-of-date” portions of those factors the SEC suggested for board consideration when approving a 12b-1 plan and the required quarterly review of the amounts expended under a 12b-1 plan.

In conclusion, Mr. Stevens noted how Rule 12b-1 is “essential” to the infrastructure that makes mutual fund investing available to millions of investors. As a result, he urged the SEC, in its review, to recognize that “the rule, for all the ways it might be improved, is basically a success story – for the fund industry and, more importantly, for investors.”

Jane G. Heinrichs
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endnotes

[1] Mr. Stevens remarks can be found on the ICI’s website at http://www.ici.org/rule12b1fees/speeches/07_aei_stevens.

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