

MEMO# 24752

December 1, 2010

ICI Submits Supplemental Economic Analysis on the SEC Proposal to Replace Rule 12b-1 With a New Distribution Framework

[24752]

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TO: ACCOUNTING/TREASURERS MEMBERS No. 39-10
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TRANSFER AGENT ADVISORY COMMITTEE No. 78-10 RE: ICI SUBMITS SUPPLEMENTAL
ECONOMIC ANALYSIS ON THE SEC PROPOSAL TO REPLACE RULE 12B-1 WITH A NEW
DISTRIBUTION FRAMEWORK

As you know, the Securities and Exchange Commission has proposed sweeping changes to the rules and disclosure requirements related to the use of fund assets to pay for the distribution of fund shares. [\[1\]](#) ICI submitted a comment letter on November 5 on the proposal, which, among other things, challenged the economic rationale for the rule and urged the SEC to take a further and more careful look at its economic analysis before proceeding with this rulemaking. [\[2\]](#) The ICI Comment Letter also indicated that, to assist

the SEC in that regard, we would conduct our own economic analysis of the proposal.

ICI's economic analysis, which is summarized below, was submitted on December 1 to the SEC as a supplement to our comment letter. [\[3\]](#) As explained more fully below, the analysis confirms our initial view that the benefits of this proposal do not outweigh its costs.

Summary of ICI's Economic Analysis

Based on our survey, we believe that the SEC understated the initial and ongoing costs of the proposal, overstated its benefits, and failed to consider certain important possible ramifications. More specifically:

- *Initial and Ongoing Costs.* We estimate that the cost of implementing the rule will be \$418 million initially, more than twice the \$159 million estimated by the SEC. We estimate that the annual ongoing costs to funds cumulated over the five-year grandfathering period would conservatively amount to \$345 million, over 8 times the \$40 million that the SEC estimated.
- *Benefits.* We see little basis for the SEC's estimate that the proposed rule will convey annual benefits to fund shareholders of \$1.1 billion to \$1.3 billion. These estimates are based on the assumption that by capping the asset-based distribution fees investors pay to intermediaries through funds, they will pay intermediaries less overall yet still receive comparable services. We believe this ignores market realities, and that the SEC's estimates of \$1.1 to \$1.3 billion in savings are best interpreted not as a net benefit to investors but as a reduction in the fees that investors would pay *through* mutual funds matched by a one-for-one dollar increase in fees that they would pay *outside* of funds, in effect doing nothing more than "squeezing a balloon."
- *Other Potential Ramifications.* Both the economic analysis and the ICI Comment Letter highlight areas that the SEC's cost-benefit analysis simply does not anticipate or address fully, such as the proposal's impact on investors in retirement share classes and small investors seeking professional investment services. The economic analysis also suggests that the SEC has not fully considered the possibility that a vast restructuring of the fund distribution system could shift incentives for intermediaries to promote other, less regulated financial products and whether that would be beneficial or costly to investors.

Recommendation

Ultimately, ICI's economic analysis reiterates the views and recommendation from the ICI Comment Letter – that we believe that the proposal is far more extensive and intrusive than necessary and could fundamentally alter the way intermediaries use funds in various distribution channels, significantly affect the lineup of share class options currently available to investors, necessitate major systems changes, and require the renegotiation of thousands of dealer agreements. All of this would be done at a great cost that would be reflected in higher expenses borne by shareholders. And the benefits are uncertain and quite possibly illusory. As a result, the significant operational and transitional costs on funds, intermediaries, and investors are simply not warranted, and the SEC must take a further and more careful look at its economic analysis before proceeding with this rulemaking.

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[Attachment](#)

endnotes

[1] SEC Release Nos. 33-9128; 34-62544; IC-29367 (July 21, 2010), available at <http://www.sec.gov/rules/proposed/2010/33-9128.pdf>. For additional background, see ICI Memorandum No. [24449](#), dated July 28, 2010.

[2] See letter from Karrie McMillan, General Counsel, Investment Company Institute to Elizabeth Murphy, Secretary, SEC (November 5, 2010) (the “ICI Comment Letter”). See also [Memorandum](#) No. 24689, dated November 5, 2010.

[3] Investment Company Institute, *Cost-Benefit Analysis of SEC 12b-1 Reform Proposal* (December 1, 2010), available at http://www.ici.org/pdf/10_12b1_sec_cba.pdf.

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