

**MEMO# 17576**

May 25, 2004

## **ICI LETTER TO SEC CHAIRMAN DONALDSON CONCERNING PAPER ON 12B-1 FEES BY SEC STAFF ECONOMIST**

[17576] May 25, 2004 TO: SEC RULES COMMITTEE No. 48-04 SMALL FUNDS MEMBERS No. 59-04 RE: ICI LETTER TO SEC CHAIRMAN DONALDSON CONCERNING PAPER ON 12b-1 FEES BY SEC STAFF ECONOMIST The Institute has sent a letter to SEC Chairman Donaldson in connection with a recent article in the Wall Street Journal that discussed an academic paper by an SEC staff economist regarding 12b-1 fees. A copy of the letter is attached and it is briefly summarized below. The letter states that the article unfortunately presented an unbalanced view of the purpose of 12b-1 fees. The letter points out that the paper's analysis was based on the premise that the purpose of 12b-1 fees is to produce lower overall expense ratios through asset growth and economies of scale – a premise that ignores the current uses of the fees as a substitute for front-end sales loads and/or to pay for administrative and shareholder services that benefit existing shareholders. The letter states that in discussing the paper's findings, the article left a negative impression about the impact of 12b-1 fees on fund shareholders. The letter explains, however, that by disregarding how 12b-1 fees are currently used, the paper has little bearing on whether investors benefit from them. The letter goes on to note that other well-regarded researchers have recognized for some time that 12b-1 fees serve primarily as an alternative to front-end loads and that this use of the fees can provide additional choices and benefits to fund shareholders.<sup>1</sup> It adds that the Commission and its staff have acknowledged the current uses of 12b-1 fees on many occasions and, through several regulatory actions, the Commission helped build the infrastructure to support their use in these ways. The letter asserts that contrary to the implications of the article, experience demonstrates that the current uses of 12b-1 fees benefit investors in several ways. These include allowing investors the option of paying distribution costs over time, giving those who choose to own funds through a particular distribution channel access to funds that otherwise might not be available to them and, where used to pay for ongoing services to shareholders, acting as an incentive for financial professionals to continue to provide such services. <sup>1</sup> In addition, a paper by an Institute Senior Economist analyzing the effect of 12b-1 plans on mutual fund investors was enclosed with the letter. To obtain a copy of this paper, please contact Sally Coleman at 202/326-5872 or [scoleman@ici.org](mailto:scoleman@ici.org). <sup>2</sup> Finally, the letter reiterates the Institute's recommendation that any reevaluation of Rule 12b-1 should take into account the benefits of the current uses of 12b-1 fees. Frances M. Stadler Deputy Senior Counsel Attachment (in .pdf format) Note: Not all recipients receive the attachment. To obtain a copy of the attachment, please visit our members website (<http://members.ici.org>) and search for memo 17576, or call the ICI Library at (202)

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