The Asset Management Industry
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SEC STAFF ISSUES NO-ACTION LETTER ON 12B-1 FEE REBATES

[15848] April 4, 2003 TO: DIRECTOR SERVICES COMMITTEE No. 5-03 SEC RULES MEMBERS No. 41-03 RE: SEC STAFF ISSUES NO-ACTION LETTER ON 12b-1 FEE REBATES The Division of Market Regulation of the Securities and Exchange Commission recently issued a no-action letter relating to the ability of a registered broker-dealer to provide mutual fund investors with a refund of a portion of the Rule 12b-1 fees paid by mutual funds to broker-dealers.* In particular, the broker-dealer sought assurances that paying rebates of 12b-1 fees to mutual fund investors would not violate Section 15(a) of the Securities Exchange Act of 1934, which prohibits a broker or dealer from effecting securities transactions without being registered under the Act. According to the request for no-action relief, a registered representative of the broker- dealer proposed to solicit mutual fund investors by offering to provide them with a refund of a portion of the Rule 12b-1 fees paid to broker-dealers that are attributable to their investment in mutual funds. To take advantage of the program, investors would be required either to re- register their mutual fund shares in street name or name the broker-dealer as the broker of record for the shares. No investor would be obligated to purchase or sell shares through the broker-dealer. Each customer participating in the program would be screened to confirm that neither the customer nor an associated person of the customer is engaged in broker-dealer activities. Any advertising or other communications with the public relating to the program would be subject to the NASD's advertising rules. Based upon the facts presented, the staff of the Division of Market Regulation stated that it would not recommend enforcement action under Section 15(a) of the Exchange Act against any customer of the broker-dealer who, though not registered as a broker-dealer, receives a partial refund from the broker-dealer of Rule 12b-1 fees attributable to mutual fund shares owned by that customer. The letter notes that the request for no-action relief did not ask for any guidance regarding whether the proposal implicates the Investment Company Act. Notwithstanding this, the staff of the Division of Investment Management "questions whether direct or indirect rebates of 12b-1 fees by a fund are consistent with the policies and provisions of the 1940 Act." * See Edward Mahaffy (Pub. Avail. Mar. 6, 2003), which is available through the SEC's website at http://www.sec.gov/divisions/marketreg/mr-noaction/mahaffy030603.htm. 2 The staff reiterates the views expressed in the Southeastern Growth Fund no-action letter (Pub. Avail. May 22, 1986) that "any waiver or rebate of an investor's pro rata portion of the expenses incurred under a 12b-1 plan would raise serious concerns under both section 36 of the [1940] Act and general fiduciary principles." It notes that Rule 12b-1(e) requires a fund's board of directors to conclude that there is a reasonable likelihood that a 12b-1 plan will benefit the fund and its shareholders before a fund may implement or continue the plan. As such, the staff believes that providing rebates of all or a portion of 12b-1 fees "would be a pertinent factor requiring a board of directors' full consideration in reaching its

conclusion with respect to a fund’s 12b-1 plan, and the staff . . . questions whether a 12b-1 plan under which broker-dealers rebate 12b-1 fees to their customers would benefit the fund and its shareholders.” Tamara K. Salmon Senior Associate Counsel

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