

MEMO# 19497

December 20, 2005

SEC STAFF CLARIFIES POSITION CONCERNING 12B-1 FEE REBATES

©2005 Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice. [19497] December 20, 2005 TO: BROKER/DEALER ADVISORY COMMITTEE No. 38-05 BROKER/DEALER ASSOCIATE MEMBERS No. 15-05 CHIEF COMPLIANCE OFFICER COMMITTEE No. 70-05 COMPLIANCE MEMBERS No. 31-05 INVESTMENT ADVISER ASSOCIATE MEMBERS No. 18-05 INVESTMENT ADVISER MEMBERS No. 26-05 SEC RULES MEMBERS No. 132-05 SALES FORCE MARKETING COMMITTEE No. 12-05 SMALL FUNDS MEMBERS No. 105-05 RE: SEC STAFF CLARIFIES POSITION CONCERNING 12B-1 FEE REBATES The Division of Investment Management of the Securities and Exchange Commission recently issued a letter clarifying its position concerning the ability of a registered broker-dealer to rebate a portion of the Rule 12b-1 fees paid by mutual funds to broker-dealers.¹ The broker-dealer had sought clarification that it was not the staff's intent that the language from a 2003 no-action letter ("2003 Letter")² be interpreted to preclude a fund board from approving or continuing a 12b-1 plan when an unaffiliated broker-dealer rebates to its customers a portion of the 12b-1 fees. According to the broker-dealer's letter, it has entered into agreements with numerous funds and their affiliated persons (together "Funds") pursuant to which the broker-dealer receives 12b-1 fees for the sale of the Funds' shares. The broker-dealer currently offers rebates on more than 5,000 unaffiliated Funds through its rebate program ("Program") that provides a rebate to each Eligible Customer (as defined in the letter). The amount is based upon the aggregate amount of 12b-1 fees and/or administrative fees that the broker-dealer receives as a result of Fund shares held in an Eligible Customer's account. The broker-dealer developed and operates the Program in its sole discretion, completely independently of any Funds. According to the broker-dealer, it is not seeking and will not seek any approval from a Fund before rebating any fees to Eligible Customers, nor will it be subject to any agreement or arrangement, written or otherwise, between it and the Funds. 1 See E*Trade Securities, LLC, SEC No-Action Letter (pub. avail. Nov. 30, 2005). 2 See Edward Mahaffy, SEC No-Action Letter (pub. avail. Mar. 6, 2003). 2 The broker-dealer notes that it is seeking clarification from the staff because some funds affirmatively have requested that they not be included in the Program. The broker-dealer is concerned that these funds may have interpreted the staff's statements in the 2003 Letter as suggesting that, if a broker-dealer rebates 12b-1 fees to its customers, a fund's board of directors could never determine under Rule 12b-1(e) under the Investment Company Act of 1940, that there is a reasonable likelihood that the 12b-1 plan would benefit the fund and its shareholders. This interpretation of the 2003 Letter may result in broker-dealers' inability to offer customers rebate programs similar to the Program. In its letter, the staff states that it did not intend for the 2003 Letter to mean that a fund's board could never approve a fund's 12b-1 plan if

a broker-dealer rebates 12b-1 fees to its customers. Rather, the appropriateness of a board's determination would depend upon all of the relevant facts and circumstances. As an example, the staff explains that, if all or almost all of the 12b-1 fees that a fund paid to broker-dealers under its 12b-1 plan were being rebated, the fund's board might reasonably conclude, in the exercise of its business judgment, that the continuation of the plan at the current level was no longer reasonably likely to benefit the fund and its shareholders. In that event, the board might reasonably determine to discontinue the plan or reduce the amount of the 12b-1 fees paid by the fund. The staff further explains that, if a fund entered into any agreement or arrangement, written or oral, with one or more broker-dealers pursuant to which the broker-dealers rebate 12b-1 fees to select shareholders of a class of the fund's securities, the fund would be indirectly treating some shareholders differently in violation of Sections 18(f), 22(d), and 48(a) of the Investment Company Act. Jane G. Heinrichs Associate Counsel

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.