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November 5, 2010

Via E-Mail to rule-comments@sec.gov

Ms. Elizabeth Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: Proposed Rule and Rule Amendments Regarding Mutual Fund Distribution Fees and Confirmations (Release Nos. 33-9128; 34-62544; IC-29367; File Number S7-15-10)

Dear Ms. Murphy:

OppenheimerFunds, Inc. ("OppenheimerFunds")[1] is pleased to submit comments to the proposal by the U.S. Securities and Exchange Commission (the "SEC" or "Commission") to rescind Rule 12b-1, amend existing rules and adopt new rules to govern mutual fund distribution fees, confirmations and issues related thereto (the "Proposal").[2]

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[1] OppenheimerFunds is a registered investment adviser, providing investment management, transfer agency and, through its wholly owned subsidiary, OppenheimerFunds Distributor, Inc. ("OFDI"), distribution services to 94 registered investment companies. OppenheimerFunds, with more than $170 billion in assets under management, has been in the investment advisory business since 1960. The OppenheimerFunds mutual funds are sold to members of the public primarily by financial intermediaries that have selling agreements with OFDI.

[2] Mutual Fund Distribution Fees; Confirmations, Securities Act Release No. 9128; Exchange Act Release No. 62544; Investment Company Act Release No. 29367) (File No. S7-15-10) (proposed July 21, 2010); 75 Fed. Reg. 47064 (August 4, 2010) [hereinafter Proposal]. The proposed rules specifically propose the rescission of rule 12b-1

I. Introduction

We commend the Commission's effort to improve transparency and investor protection in the context of mutual fund distribution fees. We support efforts to promote healthy competition, promote investor understanding of sales charges and fees and permit investors to choose investment and service arrangements that are appropriate for them. As described in further detail below, we are concerned that these goals will not be met under the Proposal, that the Proposal is unclear on some key issues and that the difficulty and expense of implementing the proposed changes outweigh the perceived benefits. Without substantial changes, we do not believe that the Proposal will achieve its stated goals.[3]

Mutual fund distribution has grown more complex and sophisticated since Rule 12b-1 was originally enacted in 1980.[4] The challenges created by that growth and evolution are evident throughout the Proposal. The mutual fund industry has prospered and the market conditions that originally prompted the enactment of Rule 12b-1 may no longer exist, but the Rule and associated distribution practices have become inextricably woven into the marketplace over the past thirty years.[5] Investors have many more choices today in terms of the variety of funds available, the types of intermediaries that distribute those funds and the options (including sales charge arrangements) offered by those intermediaries to obtain such funds. We also recognize that FINRA member firms are not the only intermediaries that provide distribution-related services, and we believe strongly that with proper disclosure, paying for distribution-related activities remains an important and appropriate use of fund assets.

Investors have benefited from the industry's growth and the evolution of distribution models. Although we appreciate and share the Commission's concern for the welfare of investors, it is not clear to OppenheimerFunds that the Proposal seeks to cure any material market deficiency. The two major substantive components – limiting ongoing sales charges and

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under the Investment Company Act of 1940 (the "Investment Company Act"), a new rule 12b-2 under the Investment Company Act, amendments to rules 6c-10 and 11a-3 under the Investment Company Act, amendments to rule 10b-10 and Schedule 14A under the Securities Exchange Act of 1934 (the "Exchange Act") as well as amendments to Form N-1A under the Investment Company Act and the Securities Act of 1933 (the "Securities Act"), amendments to rule 6-07 of Regulation S-X under the Securities Act, technical changes to rule 10b-10 and various technical changes and conforming changes to rules and forms under the Investment Company Act.

[3] Page 2 of the Proposal states that the proposed rules are designed to "protect individual investors from paying disproportionate amounts of sales charges in certain share classes, promote investor understanding of fees, eliminate outdated requirements, provide a more appropriate role for fund directors, and allow greater competition among funds and intermediaries in setting sales loads and distribution fees generally."

[4] *See* Proposal, *supra* note 2, at § II.C.

[5] *Id.* at 16.

creating a new option for account level sales charges – are solutions in search of a problem. The proposal to limit ongoing sales charges affects a fraction of the market, in which smaller advisers and shareholders have use distribution support to pay for much-needed investment services. Without this framework, many small shareholders would likely be unable to get guidance which they, perhaps more than any other group of investors, sorely need to make prudent investment decisions. With adequate disclosure of charges and costs and effective regulatory oversight, there is no reason that investors should be denied the right to choose the mode of paying for services that best suits their needs. Likewise, the Commission has proposed the account level sales charge in order to create competition in the pricing of services,[6] but competition of this kind already exists in intermediary wrap and similar programs offering load-waived share classes and institutional share classes carrying no, or very low, sales charges and fees.

For the sake of these perceived needs, the Commission would have fund providers incur substantial expense (which we believe the Proposal significantly underestimates) to create share classes (to replace current share classes having asset-based compensation arrangements with new classes after the compliance date) and conversion features while important structural regulatory initiatives relating to sales and distribution activities (*e.g.*, standards of care, point of sale disclosure) remain on the horizon. Instead, the Commission has focused its own considerable resources on issues that are in our opinion peripheral, rather than central, to the modern financial services industry in which mutual funds are now distributed. Rather than reexamining the fundamental premises on which the regulation of mutual fund distribution is based and trying to simplify it, the Proposal only adds complexity, risk and expense to the byzantine structures that have grown out of the regulatory approach that the Commission and FINRA have taken.

OppenheimerFunds has addressed one of these underlying premises in a separate comment letter also submitted today (the "OppenheimerFunds Regulatory Rationalization Letter"). A central issue in mutual fund distribution is the SEC's continued differentiation of how intermediaries may be paid for distribution-related services on the basis of whether they are registered as brokers or as investment advisers, and on whether the payment is asset-based or transaction-based. As set forth in the OppenheimerFunds Regulatory Rationalization Letter, particularly as investment adviser and broker-dealer service models and standards of care converge, we believe this approach is based on outdated views of the market for mutual funds and services. We believe that a reexamination of this issue could lead to a simpler regulatory approach under which mutual fund assets may be used to support distribution-related services, without complex structures or confusing distinctions among intermediaries, types of services, classes of shares and modes of payment.

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[6] *See id.* at 88 n.268 (citing commentary on the inefficiencies of current marketplace competition).

OppenheimerFunds recognizes that the Commission's staff has spent substantial time and energy to bring a 12b-1 reform proposal to this point. The subject has been considered and sidelined several times in the past. As noted above, OppenheimerFunds believes that there are important issues that should be resolved as a prerequisite to the reform of Rule 12b-1. In the event that the Commission nonetheless moves ahead at this time, we have the following general and specific comments on the Proposal.

II. Concerns Regarding Timing, Regulatory Framework and Costs

a. The Proposal is premature in the context of the statutory Dodd-Frank mandates.

i. Financial intermediary standard of care issues are closely tied to mutual fund share class pricing.

Although we support improvement of the regulation of mutual fund distribution fees, we believe that the Proposal is premature in light of the Commission's examination of standards of care applicable to broker-dealers and registered investment advisers in dealings with retail clients under the Dodd-Frank Wall Street Reform and Consumer Protection Act.[7] The standard of care issue has significant consequences for mutual fund distribution that involve the very desirability, propriety and suitability of fund share classes and fee structures. Moreover, services intermediaries provide in connection with mutual fund shares – notably including guidance to investors on their investment decisions – affect and are affected by the applicable standard of care. As such, the proper characterization of those services for "distribution" purposes is likewise related to the standard of care issue.

The Proposal, however, is unclear on whether investment guidance is fairly characterized as "distribution." The Proposal notes commentary to the effect that some intermediaries use 12b-1 fees to "pay for *valuable ongoing investment advice* provided by the intermediary,"[8] and appropriately raises the question whether fund assets should be used for ongoing services years after an initial transaction. Specifically, the Proposal asks: "Are asset-based distribution fees associated with level load share classes an efficient means to pay for ongoing investment advice?"[9] This appears to be an acknowledgement by the Commission that, at least in the eyes of some, these fees could be used to compensate intermediaries for advice or other ongoing

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[7] Section 913, "Study and Rulemaking Regarding Obligations of Brokers, Dealers, and Investment Advisers," Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010).

[8] *See* Proposal, *supra* note 2 at 124 and n.370 (emphasis added) (noting commentary by some that 12b-1 fees typically associated with class C shares (level load) are for continuing advice, as a substitute for a fee-based model).

[9] *Id.* at 124. Our response would be "yes, with appropriate disclosure and oversight."

services and are widely accepted as a means of paying for them. Nonetheless, the Proposal also characterizes the ongoing sales charge ("OSC") as a front-end load substitute payable only to brokers because they arise from "transaction" related services. However, the fact that both the proposed marketing and service fee and the OSC are paid over long periods makes it difficult, if not impossible, to continue to equate either of them to front end loads on sales that took place years before. If these payments were to be construed as compensation for distribution-related activity, they might be regulated differently.[10]

If there were a change to the standard of care and rationalization of the role and compensation structure for broker-dealers and investment advisers, the expensive infrastructure and technology upgrades that the Proposal contemplates could be rendered unnecessary. At a minimum, we believe that such potential changes mandate a comprehensive re-examination of the cost-benefit analysis of the Proposal. Until there is greater clarity in the standards of care being applied to brokers and investment advisers, the tremendous operational and financial undertakings inherent in the Proposal are not reasonable or appropriate, and the harmonization of legal standards should be the paramount question before the Commission at this time.

ii. The Commission should consider point of sale disclosure regulation for all securities rather than confirmation disclosure of mutual fund fees.

Similarly, OppenheimerFunds believes it is premature to create new rules for disclosures in mutual fund transaction confirmations while the larger issues of point of sale disclosure remain pending and largely uncoordinated in timing or substance.[11] Even if confirmation statements were an appropriate place for distribution fee disclosure (which they are not, coming as they do *after* the investment decision has been made and no later than the delivery of the fund prospectus having full disclosure of such fees), the Proposal singles out mutual funds for far greater fee disclosure requirements than other investment products. Moreover, the proposed confirmation disclosure would address only few of the substantive concerns the Commission has raised regarding fee disclosure to investors' informational needs. We believe that those issues are better addressed in a comprehensive point of sale disclosure rule applicable to securities

[10] *Id.* at 124-25 and n.372.

[11] We note the recent issuance by FINRA of a "Concept Proposal to Require a Disclosure Statement for Retail Investors at or Before Commencing a Business Relationship," FINRA Regulatory Notice 10-54 (October 2010), as well as earlier "Point-of-Sale" proposals by the Commission and FINRA that have not yet been finalized, as discussed below. We also note the U.S. Department of Labor's recent final regulations regarding disclosure to participants in individual account retirement plans requiring a comparative chart setting forth important elements, including fees, applicable to the various investment options available to participants. *See generally* Fiduciary Requirements for Disclosure in Participant-Directed Individual Account Plans, 75 Fed. Reg. 64909 (Oct. 20, 2010) (codified at 29 C.F.R. § 2550 (2010)) ("DOL Participant Disclosure").

products generally rather than targeting mutual fund shares in this way.[12] As the Commission has yet to take further action on its point of sale proposal from 2005, OppenheimerFunds believes that a partial rulemaking covering a single investment product is not an effective method to help investors gain a better understanding of distribution-related costs, arrangements and potential conflicts of interest on the part of intermediaries.[13]

b. FINRA members are not the only intermediaries providing distribution-related services; therefore, FINRA is not the correct regulatory body to govern fees funds pay for such services.

i. Requiring FINRA registration for recipients of fund distribution fees is unwarranted.

We disagree with the view that only intermediaries registered as broker-dealers under the Exchange Act should be permitted to receive fees from funds to support distribution-related activities with respect to fund shares, and therefore do not believe that FINRA is the appropriate regulator of mutual fund distribution fees. As set forth in the OppenheimerFunds Regulatory Rationalization Letter, it is now well understood that the business models and services provided by different types of intermediaries have evolved and, in many cases, converged. Investors generally do not understand or appreciate the differences in their advisors' regulatory frameworks.[14] As the Commission recognizes on page 7 of the Proposal, the many structures of mutual fund sales charges, service fees and share classes are only partially, if at all, fairly characterized as trading commissions for brokerage activity.

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[12] The Commission acknowledges this issue in footnote 222 on page 68 of the Proposal, stating that "[i]n this regard, the staff is considering recommendations for our future consideration to enhance the information provided at the point of sale. We also note that Section 919 of the Dodd-Frank Wall Street Reform and Consumer Protection Act states '[n]otwithstanding any other provision of the securities laws, the Commission may issue rules designating documents or information that shall be provided by a broker or dealer to a retail investor before the purchase of an investment product or service by the retail investor.'" *See also* DOL Participant Disclosure at 64915, affirming the need for disclosure that crosses the many types of investments, including separate accounts and bank collective investment trusts, which are available to many group retirement plans.

[13] *See generally* Confirmation Requirements and Point of Sale Disclosure Requirements for Transactions in Certain Mutual Funds and Other Securities, and Other Confirmation Requirement Amendments, and Amendments to the Registration Form for Mutual Funds, Securities Act Release No. 8358; Exchange Act Release No. 49148; Investment Company Act Release No. 26341 (proposed Jan. 29, 2004) 69 Fed. Reg. 6438 (Feb. 10, 2004) and Point of Sale Disclosure Requirements and Confirmation Requirements for Transactions in Mutual Funds, College Savings Plans, and Certain Other Securities, and Amendments to the Registration Form for Mutual Funds, Securities Act Release No. 8544; Exchange Act Release No. 51274; Investment Company Act Release No. 26778 (proposed Feb. 28, 2005) 70 Fed. Reg. 10521 (Mar. 4, 2005).

[14] *See* RAND CORPORATION, INVESTOR AND INDUSTRY PERSPECTIVES ON INVESTMENT ADVISERS AND BROKER-DEALERS, (Jan. 2008) at xix (noting that "[i]nvestors had difficulty distinguishing among industry professionals and perceiving the web of relationships among service providers."), *available at:* http://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf [hereinafter RAND REPORT].

The Commission should permit all intermediaries who provide distribution-related services to receive fund assets as payment, whether the intermediary is a registered investment adviser, a broker-dealer, or a recordkeeping or administrative agent. The regulatory status of the receiving firm should not control the determination of whether fund assets can be a source of payment, as long as the service is "primarily intended to result in the sale" of shares of the fund.

As a corollary, because all intermediaries who provide distribution-related services should be permitted to be paid from fund assets, we do not believe that FINRA, a regulatory body whose membership is comprised solely of registered broker-dealers, should regulate the fees payable for by mutual funds that pay for those distribution-related services. If FINRA is to continue in its role, however, at the very least the Commission must defer implementation of the Proposal because of the substantial additional time required to accommodate the FINRA rulemaking process.

ii. Fund firms cannot effectively oversee intermediaries' regulatory status.

If the Commission continues to regulate payments for distribution-related services on the basis of the regulatory registration of the recipient, we believe it should focus oversight of receipt and use of distribution-related fees in larger part on the intermediaries who receive and use them, not on the mutual funds that pay them. Today, mutual funds and their distributors take numerous measures intended to ensure that intermediaries are performing the functions assigned to them in a compliant manner.[15] This is especially true with respect to the oversight of intermediaries' servicing functions for their clients, the shareholders.

The oversight has become increasingly challenging.[16] The Proposal acknowledges that mutual fund distribution may occur at the "omnibus" trading level through intermediaries. In addition, the distribution of shares has increasingly relied on networked trading through the NSCC.[17] We estimate that approximately 78% of accounts in the Oppenheimer funds are held by third party administrators, omnibus account providers or through networked accounts where OppenheimerFunds does not have complete or, in many cases, any information about the underlying shareholder. Thus, OppenheimerFunds' connection to and knowledge of the ultimate shareholder is becoming increasingly attenuated. If a mutual fund is permitted to use its assets to

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[15] *See, e.g.*, Rule 38a-1 under the Investment Company Act, under which funds are required to "[a]dopt and implement written procedures reasonably designed to prevent violation of the federal securities laws by the fund." Rule 38a-1(a)(1).

[16] *See* RAND REPORT *supra* note 14 at 9-11.

[17] *See generally* INVESTMENT COMPANY INSTITUTE, NAVIGATING INTERMEDIARY RELATIONSHIPS (2009), *available at:* http://ici.org/pdf/ppr_09_nav_relationships.pdf.

provide compensation for ongoing services that extend beyond a single purchase or sale transaction, and if investors have made purchase decisions after receiving appropriate disclosure and information about the intermediary's role as well as the investment vehicle, it should not be incumbent on the mutual fund firm to attempt to police the intermediary's conduct as well as its own. Mutual funds generally are not designed to monitor such conduct of others and do not have employees or staff for this type of activity.[18] At OppenheimerFunds alone, this would require the funds (with no employees) to monitor over 225 intermediaries (including networking level 3 broker-dealers, super omnibus firms and retirement plan administrators). Therefore, OppenheimerFunds believes that this type of oversight is better suited for an appropriate regulatory body.

c. Purported benefits of the proposed changes do not outweigh the costs.

We strongly urge the Commission to re-examine the cost-benefit analysis included in the Proposal, as we do not believe that the Commission has accurately estimated the costs or consequences associated with share class development, conversions and exchanges and increased disclosure on confirmation statements.[19] In addition, OppenheimerFunds is concerned that the increased costs would render mutual funds less attractive to shareholders relative to other investment products that, to date, have been subject to a less robust regulatory structure than the one applicable to registered investment companies. If the Commission decides to proceed with adopting the proposed rules, for reasons stated in more detail below, our assessment of the costs and the dedication of resources required to comply with the changes would substantially outweigh the potential benefits.

III. Specific Comments

a. Proposed Rule 12b-2 – The Marketing & Service Fee.

The Commission has proposed Rule 12b-2, which would permit a fund to deduct an annual fee of up to 25 basis points, the current NASD service fee limit. The fee would be disclosed in the fund's fee table as an ongoing expense for "distribution activities." We appreciate the Commission's recognition of the importance of allowing funds to pay for

[18] *See generally* Mutual Fund Redemption Fees, Investment Company Act Release No. 27504 (2006) [hereinafter Redemption Fees].

[19] To add a new share class for all of our funds would cost millions of dollars in development and other technology costs. Additionally, OppenheimerFunds would incur significant costs to prepare and file individual registration statement updates necessary to add new share classes. If these updates could not be coordinated with annual registration statement updates, we would also incur costs in printing and mailing new summary prospectuses (which would cost over $2.5 million for a stand-alone mailing of a new summary prospectus for all funds).

distribution-related services.[20] We support a plain English approach to the description of this fee, but we believe that a final rule should be clearer with regard to the expenses and activities it is designed to cover and to what extent the fund board should be involved in this assessment. We agree with the Commission's view that fund boards need not review service fee plans, but we are concerned that the Proposal could be interpreted as requiring a detailed assessment and board appraisal of distribution activity that may become more onerous than the current 12b-1 requirements. We also believe that the costs associated with implementing proposed Rule 12b-2 will be more than the Commission anticipated and will outweigh the potential benefits. Finally, as noted above, we do not believe that the amount of fees payable under proposed Rule 12b-2(b) should be governed by FINRA rules. We explore each of these points in more detail below.

i. The proposed guidance on distribution-related activity is ambiguous.

We believe that the Proposal's bifurcation of funds' asset-based payments into marketing and service fees and OSCs, and the discussion of "non-distribution fees" is unclear and confusing.[21] The Proposal suggests that funds' payments for administrative or recordkeeping expenses are not *necessarily* for "distribution-related activities." Notably, the fear that such payments could be classified as payments for distribution has led some complexes to include them in "defensive" 12b-1 plans. The Proposal does not offer clear guidance about the proper treatment of such payments; rather, it suggests that such fees are not for distribution to the extent they are purely administrative, while at the same time suggesting that some administrative payments may in fact be payments for distribution-related activity and should be counted against the 0.25% limit.[22]

OppenheimerFunds suggests that a more realistic approach is to recognize that assisting with administrative costs encourages intermediaries to sell shares of the fund. Such administrative services have often been paid for outside of 12b-1 plans. Accordingly, if such payments are now governed by proposed Rule 12b-2, the Commission might logically conclude that the cap on those payments should be greater than 0.25% (particularly, as other commenters

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[20] Proposal, *supra* note 2 at 91: "[w]e are not proposing to require funds to externalize their distribution expenses". *See also* Proposal at 90 n.276 and 91 n.278 (referencing comments received to Prohibition on the Use of Brokerage Commissions to Finance Distribution, Investment Company Act Release No. 26356 at section IV (Feb. 24, 2004) 69 Fed. Reg. 9726 (Mar. 1, 2004), *available at:* http://www.sec.gov/rules/proposed/s70904.shtml.)

[21] *See* Proposal, *supra* note 2 at 41 n.153.

[22] In particular, we have reservations about potential penalties that could be imposed by the Commission for a discrepancy between its view and our view on the characterization of administrative expenses, as cited in footnote 153 (referencing the Commission's settlement proceedings for In the Matter of BISYS Fund Services, Inc., Investment Company Act Release No. 27500 (Sept. 26, 2006)).

have pointed out, in connection with shares classes designed for retirement plans). At a minimum, the Commission should clearly delineate which services and payments are distribution-related and which are not, rather than leave funds and their advisers with the same ambiguity that prevails today on this issue.

ii. Changing the amount of a 12b-2 fee may be beneficial, but would require significant operational costs.

OppenheimerFunds believes that the Commission has grossly underestimated the costs associated with implementing the new proposed Rule 12b-2 change. First, if the amount of the 12b-2 fee is different from the current 12b-1 service fee of 25 basis points, many funds will need to create new share classes to accommodate both fees during the implementation and grandfathering period while old and new classes co-exist, incurring significant costs. As funds would generally not have the ability to charge one level of fees to certain assets and another level of fees to other assets, they would need to create a new class of shares, which would entail significant legal and technology costs as well as "blue sky" fees.

Even if the 12b-1 fees and 12b-2 fees were equal, the funds would have to incur similar expenses of creating new share classes if they are not specifically permitted to maintain both 12b-1 and 12b-2 fees within the same share classes during the grandfathering period. We believe that the Proposal leaves this issue unanswered, and we would like the Commission to clarify or provide relief that during the transition period, funds would not be forced to temporarily create new share classes simply to accommodate the payment of both fees during the transition period.

iii. The Commission should regulate payments directly, and funds should be permitted to pay any intermediary that performs distribution-related services.

The Proposal suggests that at least some payments funds would make under proposed Rule 12b-2 are not the equivalent of front end loads or sales charges,[23] and therefore may be paid to entities other than FINRA members. As described above, OppenheimerFunds believes that it is not appropriate to tie the regulation of these payments to FINRA's rules. As noted in the OppenheimerFunds Regulatory Rationalization Letter, especially with converging standards of conduct, we do not believe that payment of fund assets for distribution-related activities should be limited to registered broker-dealers. If the Commission determines that FINRA is the proper regulator in this area, however, we request that the Commission make the point clearly and definitely and explain its rationale, rather than rely on the oblique statement in footnote 168 of the Proposal that "[m]arketing and service fees paid to an intermediary may similarly require the

[23] Proposal, *supra* note 2 at 43-45.

intermediary to register under the Exchange Act." We disagree with the suggestion in the footnote, but at a minimum, we believe the industry is entitled to greater clarity than is provided in the Proposal.

b. Proposed Amendments to Rule 6c-10 – The Ongoing Sales Charge.

The Proposal would permit a fund to deduct asset-based distribution fees as an "ongoing sales charge," or OSC, subject to a maximum "reference load" and a mechanism to convert the shares to a class of shares without an OSC.[24] The Proposal states in several places that the OSC is simply a form of sales load,[25] and would allow for an investor to spread payment of the sales load over a period of time, rather than allow it to be collected indefinitely.

i. The "reference load" is not a realistic means of curbing excessive fund fees.

OppenheimerFunds understands the Commission's concerns with excessive fees, but we remain concerned with the conceptual and operational issues presented in the Proposal. As an initial matter, it is not clear why a regulator should be in the ratemaking business. Brokerage commissions were deregulated thirty-five years ago, and the result has been an inexorable decline in the cost of execution to the point where shares can be traded electronically for fractions of a penny per share.[26] FINRA and the Commission are able to police "excessive commissions" in that area without resort to establishing *per se* caps. Moreover, the proposed "account level sales charge" option indicates that the Commission believes that the market can create price competition in the sale of mutual fund shares. It is not clear why the Commission appears to believe that the same competitive forces cannot keep charges in check when set by funds and charged against mutual fund assets. This applies to front end loads, OSCs, and service and marketing fees alike.

Further, as noted above, the regulation of these charges is presumably based on the notion that they are analogous to front end loads. Because the Proposal suggests that front end loads, OSCs, and various charges and fees associated with the distribution of mutual funds are simply

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[24] Proposed Rule 6c-10(b).

[25] *See, e.g.*, Proposal, *supra* note 2 at 47: "In short, the proposed rule would treat ongoing sales charges as another form of deferred sales load." *See also id.* at 62: "In view of the NASD rule and our intention to treat ongoing sales charges as another form of sales load..."

[26] *See id.* at 89: "[A]s we noted in 1983 in connection with a rule proposal under section 22(d), the concern of unjust price discrimination among purchasers has been substantially dispelled by the results achieved from the unfixing of brokerage commission rates in 1975 after our adoption of rule 19b-3 under the Exchange Act."

different ways of paying for distribution-related services for investors, however, the Commission's true perspective on these fees remains opaque.

The Commission states that "sales loads" are one of several forms of payment for "services" that intermediaries provide,[27] but it is not apparent that those services are for brokerage – defined in the Exchange Act as "effecting transactions in securities for the account of others."[28] Moreover, it is not apparent when those services begin, end, or are no longer necessary. These charges are not uniform across the spectrum of investors' needs or different share classes. The Proposal strikes an arbitrary balance, permitting funds to set a payment schedule for an OSC subject to a reference load, while at the same time acknowledging throughout the Proposal that the services investors have come to expect are far beyond the simple task of effecting mutual fund purchases.[29]

Depending on a fund's chosen structure, an OSC could be paid in small amounts for many years, extending for years beyond the transaction to which the fee is tied. It is therefore difficult to reason that a broker would still be collecting a "brokerage commission" or sales load ten years after an initial transaction, for example. A financial advisor may continue to provide service, but the logical conclusion for extended OSC structures is that "sales loads" are not simply transaction-based compensation (*i.e.*, commissions), and consequently should not be tied to a "reference load." In addition, as noted above, the Commission's inconsistent characterizations of the proposed OSC strongly suggest that the charges should be payable to any intermediary who continues to perform services for the shareholder.

In the case of "C" shares, for example, the Commission recognizes that this reform is likely to have the most significant effect on smaller shareholders who may need additional services, presumably a class of the investing public that the Commission seeks to protect the most. If the market is willing to bear and support this type of arrangement, we do not believe that the mutual fund industry's hands should be tied in providing this choice for investors. Instead, the Commission should focus its efforts on protecting investors from unscrupulous broker conduct.

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[27] *See id.* at 7: "Investors can select among many types of intermediaries from which they can purchase fund shares, and have choices as to how they pay for the services of those intermediaries. They may pay a 'sales load' at the time they purchase shares, or a deferred sales load when they redeem shares, or they may invest in a fund that pays ongoing sales charges on behalf of investors from fund assets, otherwise known as 12b-1 fees."

[28] Exchange Act, § 3(a)(4).

[29] *See* Proposal, *supra* note 2 at 49.

ii. Mutual funds cannot supervise transactions in shares with an OSC.

The Commission has taken steps to reduce "churning," whereby investors are duped into exchanging investments in order to generate new commissions for their financial advisors.[30] Although perhaps not meeting the technical definition of churning, we are concerned that the OSC cap could create an incentive for unscrupulous intermediaries to seek to switch their clients' assets from fund to fund to reset the "OSC clock" and continue collecting sales charges. An intermediary also could recommend funds with accelerated OSC schedules for which they would receive fees quicker and subject to less risk of redemptions over share classes that have longer payment schedules, when both are suitable for the investor. Particularly with the explosive growth of omnibus accounts, the Commission has previously recognized the difficulties funds face in overseeing omnibus trade processing, which effectively removes funds from having direct oversight of shareholder trading.[31] Consequently, we believe that mutual fund companies cannot and should not be responsible for any aspect of financial advisor compliance with the rules against churning and similar practices, as funds cannot effectively monitor for or prevent these activities.

iii. A standard reference load would help mitigate operational and other concerns about mutual fund responsibilities related to the OSC.

If the Commission chooses to proceed with the OSC, we have grave concerns about operational aspects of its implementation. First, we believe that tracking and converting shares will be very expensive and difficult to manage. While we support the proposed definition of "conversion period" in proposed Rule 6c-10(d), under which shares would convert on a monthly basis,[32] we are concerned that operationally, managing instances where different funds use different reference loads presents many challenges from an operational perspective. Currently, most fund families that offer convertible share classes (e.g. "B" shares and "C" shares) convert all such shares for all funds on the same schedule. Requiring different conversion schedules will require substantial programming, with our estimated costs running into millions of dollars if funds have different reference loads. Thus, if the Commission proceeds with this proposed

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[30] *See, e.g.*, "SEC and ASC Charge Alabama Broker-Dealer for Rampant Churning and Extensive Supervisory Violations" at http://www.sec.gov/news/press/2009/2009-134.htm; In the matter of Donald A. Roche, Exchange Act Release No. 38742 (June 17, 1997).

[31] *See* Redemption Fees, *supra* note 18.

[32] *See* Proposal, *supra* note 2 at 48-9, proposed rules 6c-10(b)(1)(i) and 6c-10(d)(2).

mechanism, OppenheimerFunds strongly urges the Commission to adopt a uniform reference load across all funds.

Additionally, exchanges between funds would become substantially more complicated and, in some cases, may even be prohibited due to system limitations. For example, when faced with an exchange between funds that have different reference loads, OppenheimerFunds would have difficulty tracking any amounts already paid by a shareholder. Many fund families distribute fixed income funds that have a lower sales charge structure than their equity funds. If conversion difficulties required exchanges to be limited to funds with the same front end sales charge structure, a shareholder's ability to exchange between different asset classes or to move out of a volatile market into a money market fund would be restricted. In our view, it is unclear from the Proposal how an exchange from a share class that had a higher reference load would work if those shares were exchanged for shares of a fund that have a lower sales load. This dilemma would be exacerbated if the exchange of the first fund was done into the second fund at a point during which that shares of the second fund would have already converted to another class of shares. On the other hand, programming a transfer agent system to be able to track different conversion periods for different shares in the same class of shares would be very expensive, and we believe that this concept would be exceptionally confusing to shareholders.

Also, we are concerned that funds would be forced to assume additional liability and costs with respect to omnibus accounts, as intermediaries would have to provide information to transfer agents in order to track share lots.[33] For such accounts, we are also unsure what consequences would arise if an intermediary responsible for providing such information was either not compliant or went out of business, leaving the mutual fund company with no sound basis on which to track an OSC already paid.

c. Proposed Rule 6c-10(c) and Section 22(d) Amendment – "Account-Level Sales Charges".

The proposed rules include an amendment to section 22(d) of the Investment Company Act and proposed Rule 6c-10(c) that would provide funds with an option to offer shares at net asset value, and allow intermediaries to charge their own commissions or charges. The Commission anticipates that this would "expand the range of distribution models available to mutual funds, enhance transparency of costs to investors, promote greater price competition, and

[33] Proposal, *supra* note 2 at 52-53. Also, in footnote 284, the Proposal raises the issue that some intermediaries (*e.g.*, retirement plans and insurance companies) may not even track historical share lot information. *See also id.* at § III.M.5.

provide a new alternative means for investors to purchase fund shares at potentially lower costs."[34]

We support the Commission's efforts to promote investor choice and transparency, and we believe this could be a beneficial option to the investing public in theory, but we believe that as proposed, the Proposal's unintended consequences may thwart these goals. First, we note that this type of competition already occurs. The current industry practice of selling "A" shares at net asset value in certain cases, and selling institutional shares at net asset value is one example. Given the current practice, we are not convinced of the efficacy of this proposal in achieving the desired result of alternative distribution options. Moreover, we believe that the Commission has not fully considered the appropriate allocation of compliance and administrative responsibilities under this proposal. It is not clear from the Proposal that the fund would be absolved of all recordkeeping or other administrative duties.

Second, we are concerned that the investing public may be even more confused by different pricing models for the same product, although we note that these options do currently exist in the market. In addition, we are concerned that the intermediary-determined fees may create the illusion that a higher fee means a higher level of service, and a lower fee would be commensurate with a lower level of service, which may not be the case. Consequently, we believe that this may be misleading, and would particularly disadvantage small shareholders. We also have concerns that if market forces ultimately result in lower revenue streams to intermediaries, the intermediaries may look to supplement such "losses" through compensation in other areas, as the Commission duly noted in the Proposal.[35]

Finally, and perhaps most importantly, we are concerned about the ramifications when a broker-dealer either goes out of business or terminates its FINRA membership. In such a circumstance, a shareholder's account would default to an "orphan" account. The fund company may have a limited purpose broker-dealer that could act merely as an "order taker" for the account, although the shareholder would be left with no broker to provide services. Alternatively, would the fund be responsible for finding another broker to service the shareholder? Would the fund be required to liquidate the shareholder's account? How would the portion of a broker-charged commission charged to that point be handled? The Proposal provides no guidance on how to handle these or the many other issues that we believe will arise from this foreseeable problem.

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[34] *Id.* at 90.

[35] *See id.* at 202 and n.505. We note that this principle and concern would be affected by other areas of the Proposal as well, and we anticipate that intermediaries that would be affected by any reduction in existing revenue streams would seek to recoup that revenue through other means.

d. Disclosure Amendments; Proposed Amendments to Rule 10b-10 – Transaction Confirmations.

The Proposal contains amendments to Rule 10b-10 of the Exchange Act, requiring further disclosure to transaction confirmation statements. The Proposal also contains amendments to prospectus disclosures, particularly in the fee table and description of payments to intermediaries, and we generally support those changes.

We disagree, however, with the proposed increase in confirmation statement disclosure, as we believe that it would merely increase costs without providing any material benefits to shareholders. A transaction confirmation is delivered to a shareholder after a purchase of shares has been completed, and therefore it does not provide any information that is helpful to an investor in the process of making an informed investment decision. At that point, it is simply too late. In our opinion, current confirmation statement disclosure is adequate, and adding more information would either be largely ignored by shareholders, or may actually obfuscate the most important information that was meant to be conveyed by the confirmation statement.

Additionally, we are concerned that the amount of proposed disclosure could significantly increase the costs of printing and mailing confirmation statements. For example, in 2009, we sent nearly 2.6 million confirmation statements (including 2.3 million hard copies and over 200,000 electronic statements) to fund shareholders. If the new disclosure requirements added one page to the confirmation statements, this would impose an additional $194,257 in printing costs and $147,652 to $295,303 in mailing costs for an additional 0.5 to 1.0 ounce, respectively, for a total increase in annual costs of between $341,909 and $489,560. We also note the environmental cost of producing over 2.3 million additional sheets of paper annually, for disclosure that we believe will be confusing and extraneous.

As mentioned briefly above, we agree with the Commission as it notes on page 68 of the Proposal, that "providing for improved disclosure of cost information prior to the sale may be an additional step that we could consider to help investors make better informed investment decisions," and we believe the Commission should instead consider this issue in a broader discussion of point of sale regulations, as it alluded to in footnote 222 of the Proposal. Finally, we are concerned that the additional costs and disclosures that would be created by the proposed amendments to Rule 10b-10 would encourage or incentivize brokers to sell investment products not subject to such requirements.

e. Proposed "Guidance" on Board Responsibilities.

We commend the Commission's efforts in the Proposal to reduce the burden on mutual fund boards, including the board approval requirement of a formal 12b-1 plan. We also appreciate the Commission's recognition that the factors presented in Rule 12b-1 are no longer relevant. We are concerned, however, that fund boards will face great uncertainty in seeking salient information for review of distribution payment arrangements given the vague parameters in the Proposal. With regard to OSCs, for example, the Proposal suggests that fund directors use the same procedures as they do for contract renewal under section 15(c) of the Investment Company Act.[36] This strongly suggests that the Commission perceives no substantial difference in the directors' responsibility to annually review a fund's distribution arrangements, even in the absence of a formal plan. Directors are, however, charged with satisfying their fiduciary duties under state law and the Investment Company Act.[37] We question whether this duty imposes a "findings" requirement, as Rule 12b-1 currently does, and we request clarity in how mutual fund boards are expected to properly satisfy that duty.[38] In essence, we believe that the proposed rules provide no assurance that boards' abilities to oversee fund distribution or the adviser would be enhanced, or that the burden on directors, funds or advisers, is any lighter.

OppenheimerFunds is grateful for the opportunity to raise some of these complexities with the Commission and its staff. If you have any questions, please feel free to contact me at (212) 323-5062.

Respectfully submitted,

Ari Gabinet
Executive Vice President &
General Counsel - Asset
Management

cc: The Honorable Mary L. Schapiro, Chairman
The Honorable Kathleen L. Casey, Commissioner

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[36] *Id.* at 64.

[37] *Id.*

[38] According to the Proposal, directors should use their reasonable business judgment to determine, among other things, whether the underwriter's compensation is "fair and reasonable (considering the nature, scope and quality of the underwriting services rendered)" and 'whether the sales loads (including the ongoing sales charges) are fair and reasonable in light of the usual and customary charges made by others for services of similar nature and quality."

The Honorable Elisse B. Walter, Commissioner
The Honorable Luis A. Aguilar, Commissioner
The Honorable Troy A. Paredes, Commissioner
Andrew J. Donohue, Director, Division of Investment Management
Robert E. Plaze, Associate Director, Division of Investment Management