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November 5, 2010

Ms. Elizabeth Murphy
Secretary
Securities and Exchange Committee
100 F Street NE
Washington DC 20549-1090

Re: File No. S7-15-10 Mutual Fund Distribution Fees; Confirmations

Dear Ms. Murphy:

The Financial Services Roundtable[1] appreciates the opportunity to comment on the Securities and Exchange Commission's ("the Commission") Notice of Proposed Rulemaking (the "Proposal") on mutual fund distribution fees and transaction confirmations.[2] The Proposal would: (i) cap 12b-2 fees ("marketing and service fees") at 25 basis points; (ii) categorize distribution fees in excess of 25 basis-points as ongoing sales' charges ("asset-based charges") subject to an account-level cumulative maximum; (iii) amend transaction confirmations to include disclosures of 12b-2 fees and ongoing sales charges; and (iv) create an elective account-level sales charge alternative that exempts certain funds from section 22(d) of the Investment Company.

The Roundtable has carefully studied the Proposal and we support the intent underlying the Commission's attempt to reform distribution fees because we agree that the current disclosure methods with respect to mutual-fund distribution fees can and should be improved. We commend the use of improved, descriptive language capable of translating the purpose of the fee to investors. However, we are concerned certain provisions in the Proposal could lead to results that are inconsistent with the Commission's intent.

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

Proposed Rule 12b-2 would permit funds to deduct a fee of up to 25 basis points to pay for distribution activities. Rule 12b-2 and the proposed amendments to Rule 6c-10 (the automatic conversion and maximum cumulative limit) would impose a near-uniform 12b-1 plan on all mutual funds, regardless of the structure or purpose of the fund. We are concerned the Proposal

[1] The Financial Services Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America's economic engine, accounting directly for $74.7 trillion in managed assets, $1.1 trillion in revenue, and 2.3 million jobs

[2] SEC File No. S7-15-10, 75 *Federal Register* 47063 (Aug. 4, 2010) (the "Proposal").

does not fully address the impact the rule would have on new or non-traditional funds, like money market mutual funds used in sweep accounts, retirement funds, variable insurance products and small funds. For these funds, it may be impractical or extremely difficult to reduce or reclassify their distribution-related expenses because these funds often incur higher distribution-related overhead costs and service expenses.

A. The Relationship Between Proposed Rule 12b-2 and NASD Conduct Rule 2380.[3]

The Commission suggests that funds review their 12b-1 fees and segregate non-distribution related expenses to "avoid being subject to ongoing sales charge limits and conversion periods in proposed rule 6c-10(b)."[4] We appreciate the Commission's recognition that certain funds have relatively higher 12b-1 fees because of platform, recordkeeping, or investor servicing expenses, but it is important to acknowledge the other factors influencing the amount of 12b-1 fees, like the amount of assets held by a fund.[5]

We understand the Commission's suggestion that funds may be able to re-categorize a portion of 12b-1 fees as an administrative fee to avoid the 25 basis-point cap. However, for reasons explained above, we do not think this is a realistic prospect for retirement funds, small funds, and money-market sweep accounts, and we are uncertain about the benefits consumers would derive from the Proposal. It encourages funds to scrutinize their (current) 12b-1 expenses to determine what expenses are "optional" 12b-2 expenses encourages funds to reclassify "optional" 12b-2 fees into non-descript administrative or "other expenses" to avoid triggering the 12b-2 limit and we think this is inconsistent with the Proposal's express rationale of allowing investors to compare 12b-2 fees across funds. It would be difficult for investors to compare marketing and service fees across funds if Fund A includes Expense X in 12b-2 fees but Fund B categorizes Expense X as an "Administrative Expense". We do not think this was the intended result of the rulemaking, and we encourage the Commission to offer safe harbors or exemptions for certain funds with 12b-2 fees exceeding 25 basis-points.

B. Exemption for Money-Market Funds, Small Funds, and Retirement Funds.

Proposed Rule 12b-2 is ill-suited for certain funds like small funds, money-market fund sweep accounts, and retirement funds because of the fund's design and purpose (money-market sweep accounts) or because of the costs incurred in the fund's operation and distribution (retirement plans). Below, we outline the reasons why we encourage the Commission to create a safe harbor or exemption from proposed Rule 12b-2 for certain funds from the Proposal:

- <u>Small Funds:</u>

  Funds with low asset-levels or few participants are often unable to buy or access institutional shares or shares at NAV unless the plan sponsor pays a premium. Plan sponsors who want to provide shareholders access to funds at NAV or institutional funds must spend more money to obtain a more robust plan. Some platforms charge up to 40 basis points for access that can be critical to the success of a small fund or retirement plan (see below). If adopted as proposed, plan sponsors may decline to provide access to NAV or institutional

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[3] We believe a proposal that does not transpose 12b-2 fees with NASD Conduct Rule 2380 for service fees would better serve investors. The cross-reference is imprecise, and when combined with the other provisions in the Proposal, will introduce a degree of arbitrariness that is not helpful for consumers.

[4] 75 *Fed. Reg*. at 47114.

[5] *See infra* n. 6.

shares or discontinue offering plans at all. Other plan sponsors may pass the fee directly to the investor. We believe an exception for small funds is consistent with the express and implied purpose of the Proposal because of the increased distribution costs incurred by small funds to access certain high-quality investment options desired by investors. [6] The "excess" basis points bear no resemblance to a front-end sales load and should not be subject to the 12b-2 cap or the proposed maximum cumulative limit in proposed Rule 6c-10. [7]

- *Retirement Funds:*

The Proposal notes that many retirement funds charge 12b-1 fees in excess of 25 basis points to compensate a fund's financial intermediaries for the unique and ongoing services provided to shareholders over the life of the plan.[8] Financial intermediaries provide a variety of variety of services, including: advisors and broker-dealers provide services directly to shareholders and the fund; some intermediaries assist with Section 404(a) compliance and the sponsor's annual review of the appropriateness of the offered investment options. Qualified plans rely on 12b-1 fees of 50 to 75 basis points to provide recordkeeping functions and ongoing support to shareholders. Small and mid-size employers sponsoring qualified plans would face a large increase in plan sponsorship costs if they were unable to recoup expenses through 12b-1 fees, which could decrease the amount of small and mid-size employers willing to sponsor retirement plans.

Additionally, retirement funds do not have the capacity to track and age shares that would be required if intermediary compensation for services was treated as an asset-based sales charge. Unfortunately, we agree with the Commission that the absorbing the operational costs associated with developing technology capable of tracking, aging, and eventually converting retirement shares is not a viable option for retirement funds and would serve as a disincentive to offering R shares.[9] If the rule is adopted as proposed, many small employers, who are already struggling with plan expenses, will either switch to most costly (for the participant, not the sponsor) investment methods, or forego retirement plans altogether. If the fund continues to offer R shares, plan participants will bear substantially increased recordkeeping expenses.[10]

Therefore, we respectfully ask the Commission to reconsider the scope of the Proposal with respect to retirement funds. Retirement funds should be permitted to compensate intermediaries for the provision of ongoing services without having to consider that compensation as form of ongoing sales charge. A safe harbor, or in the alternative,

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[6] 75 *Fed. Reg*. at 47075, n. 153. "Funds may use the proceeds of the marketing and service fee to pay, for example, the ongoing costs of participation on a distribution platform such as a fund supermarket, giving investors a convenient way of buying share."

[7] Another reason why small funds or start-ups tend to have higher asset-based distribution charges is that both funds tend to have limited assets subject to the asset-based charge and a limited number of investors. (For example, a fund with a $500,000 in assets that charges a 1 percent asset-based charge will collect $5,000; while a fund with assets totaling $5,000,000 would collect $50,000 from a 1 percent asset-based charge). This means investors in small funds or start-ups will generally incur a higher pro-rata share of distribution. Thus, new funds seeking investors and niche funds that appeal to certain investors may need 12b-2 fees that exceed 25 basis points. If a fund grows exponentially, the investors' share of distribution costs may decrease, but for funds that remain small (e.g., small retirement funds with small accounts), the fees will remain necessary to pay for distribution and related operating expenses.

[8] 75 *Fed. Reg.* at 47098.

[9] *Id.*

[10] The recordkeeping expenses will be even more significant if there are few participants in the fund.

Commission guidance could recognize that compensation paid to intermediaries for recordkeeping and services to shareholders is not a distribution-related expense subject to 12b-2 because such services are not intended to result in the sale of shares.

- *Money-Market Funds Used In Sweep Accounts:*

Brokerages and financial institutions offer [money-market mutual fund] sweep accounts as a convenient way for investors and commercial accountholders to securely invest excess cash balances in a secure, regulated investment vehicle. Every night, the accounts automatically "sweep" a predetermined amount of cash into the investment vehicle and redeem cash balances from sweep money-market mutual funds. Customers retain access to immediate liquidity, and the account may have check writing or debit card privileges. Like retirement fund systems, the transfer agency systems used in commercial sweep accounts cannot track and age the accountholders investments; the Sweep Fund considers the intermediary as the shareholder, and the intermediary's account is an "omnibus" account. Omnibus accounts cannot track or age the shares; Sweep Fund omnibus accounts are settled in the aggregate every day, not on the subaccount level.

Intermediaries do not receive sales commissions or other compensation in connection with purchases and redemptions from sweep accounts linked to brokerage accounts or commercial checking accounts. Rule 12b-1 fees compensate intermediaries for the ongoing time and expenses required to maintain sweep accounts (*e.g.*, daily account reconciliation, tracking services, recordkeeping, shareholder services, sub-accounting, tax reporting, transaction confirmations, prospectuses, regulatory reporting).

Money-market funds used in connection with sweep accounts should be exempt from the Proposal; creating systems capable of tracking and aging shares in sub-accounts would impose a significant operational burden on intermediaries but it is unclear how the Proposal would benefit sub-account holders. Given the short-holding period (overnight) there is little risk that sweep (sub) account holders are bearing a disproportionate amount of distribution expenses and the fees associated with sweep accounts are servicing and operating costs, not distribution costs.

- *Annuities and Variable Insurance Products:*

The Proposal also raises difficult questions for certain insurance products, like variable annuity contracts issued before the effective date of the proposed rule. Insurers priced these products in reliance of 12b-1 fees to cover fund expenses. Annuities and variable products with 12b-1 fees over 25 basis points are in the same predicament as retirement plans: insurers will not be able to collect the fees necessary to distribute and maintain the same level of services to shareholders.

II. Proposed Rule 6c-10: The Ongoing Sales Charge and Account-Level Cumulative Maximum.

Rule 12b-2 would permit "marketing and service fees" in amounts up to 25 basis points. Under the proposed amendments to Rule 6c-10, any asset-based distribution charges in excess of 25 basis points would be considered ongoing sales' charges. The Proposal would permit funds to continue deducting asset-based distribution fees in excess of 25 basis points ("asset-based

fees")[11] until the shareholder paid the proposed maximum cumulative amount of asset-based distribution fees ("ongoing sales charges"), at which point the shares would convert to shares with no asset-based distribution charges. The maximum cumulative amount would be determined by referencing the highest front-end load charged by the fund or the NASD 6.25% front-load limit. The Commission's rational is its belief that asset-based fees in excess of 25 basis points are the functional equivalent of a front-end sales load and should be limited to avoid the possibility that some share classes with asset-based distribution charges pay a disproportionately large share of distribution costs.

A. Benefit to Consumers

We understand the Commission's intent to prevent unfairness, but we disagree with the assumption that asset-based charges are the equivalent of front-loads. As explained above, the Commission's reference linking asset-based distribution charges with upfront sales loads is imprecise, particularly with regard to retirement funds and sweep accounts. We also are concerned that the benefit consumers may realize from the maximum cumulative cap and automatic conversion has been overstated. For example, the Commission calculates that a shareholder who currently pays 12b-1 fees in excess of 25 basis points will pay several thousand dollars more in asset-based distribution charges than an investor in a front-load account and is subsidizing the distribution costs for the front-load account.[12] We respectfully disagree with the analysis and conclusion. The Proposal's cost-savings argument is dependent on the shareholder holding the shares for at least 20 years, when the average mutual fund investor holds shares for approximately four to eight years.[13]

B. Operational & Technological Concerns & Costs.

The shareholder specific cap and automatic conversion period will require funds, and possibly broker-dealers, to invest a significant amount of time and capital to revise their systems, and in some circumstances, purchase new systems. Many financial intermediaries use systems that cannot or do not track and convert shares, and upgrading the technology and training personnel will be a substantial investment of time and money. While larger firms may be able to bear this expense, it will be a significant hurdle for smaller funds and funds that currently lack the technical and operational capacity to track and age shares, both of which are necessary under the Proposal. These costs could make the costs of offering certain products prohibitive, and discourage funds from offering them.

Firms understand that updating technological and operational systems are a cost of doing business, but we are concerned that some firms will be forced to invest a large amount of capital that ultimately will yield little benefit to consumers with retirement fund accounts and sweep accounts. We respectfully ask the Commission to consider whether there are more cost-effective methods of protecting investors from unfair practices. In this respect, it would be helpful if the Commission provided a more thorough analysis of the cost-benefit impact on broker-dealers. Our members expressed concern that the cost-benefit analysis in the Proposal focused mostly on

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[11] 75 *Fed. Reg.* at 47064.

[12] 75 *Fed. Reg*. 47078. "After **20 years,** the difference becomes more significant: The shareholder would have paid $2,292 in asset-based sales charges compared with the $500 front-end load." (emphasis added). At 10 years, based on the Commission's figures, the shareholder with asset-based charges would pay $800 dollars, and the investor who paid an upfront load would pay $500. It is possible that at four years, the average holding time for mutual fund investors, that the investor holding shares with asset-based charges.

[13] Investment Company Institute study, *available at* www.ici.org.

the costs investment firms and funds would incur, and did not address the significant costs for broker-dealers under the Proposal.

III. Proposed Amendment to Rule 10b-10. Transaction Confirmations.

The Proposal would require transaction confirmations to include information about front-end and deferred sales charges, ongoing sales charges, and marketing and service fees "associated with transactions involving mutual fund securities."[14] We fully support providing customers with clear information about any charges a customer may incur, but we urge the Commission to reevaluate the configuration of the proposed amendments to Rule 10b-10.

Disclosures within transaction confirmation will do little to further the Commission's laudable intention to help "help investors make better-informed choices when selecting a fund that imposes sales charges."[15] Confirmations are *transaction*-based documents that customers receive *after* purchasing shares. Furthermore, asset-based distribution fees and 12b-2 fees are not transactional fees. There is a risk that placing these disclosures in transaction confirmations may lead some consumers to believe these fees accumulate or increase on a per-transaction basis.

The requirement to reconfigure certain transaction confirmation sheets could discourage broker-dealers from serving fund customers because of the difficulties and significant costs associated with the proposed revamp. Financial intermediaries have expressed concern that new regulations expected under the Dodd-Frank Wall Street Reform and Consumer Protection Act will require successive revisions of transaction confirmation systems within a period of six months.

We believe there is a more efficient manner to ensure customers receive the content of the proposed 10b-10 disclosures. We encourage the Commission to consider alternative documents where these disclosures could be included. If one goal of the Proposal is to allow consumers to compare distribution fees between shares, perhaps financial advisers or other intermediaries could direct customers to the prospectus or other relevant documents where the customer could find a simple breakdown of the fund's expenses. Unlike transaction confirmations, which always occur after the sale, the customer would receive this information *before* the sale, which would allow the customer to compare fees in funds before making the purchase.

IV. Proposed Rule 12b-2(d). Grandfathering Period.

If the proposal is adopted as it is written, shares distributed prior to the effective date of the new rule would have five-years to become compliant with the Proposal's provisions. The Commission reasons that investors in mutual funds with existing 12b-1 fees should also benefit from the proposed revision of mutual fund fees and confirmations. The proposed rule's retroactive effect on funds established prior to the effective date of the rule is concerning. These funds were set up in reliance on the 12b-1 fees that under the new rule would exceed the proposed 12b-2 cap. We are concerned the Proposal will create contractual issues for funds, and we ask that the Commission take this into account when evaluating the mandatory compliance date and length of the grandfathering period.

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[14] 75 *Fed. Reg*. 47082-83

[15] 75 *Fed. Reg*. 47064, 47064 (Aug. 4, 2010).

V. The Alternative Distribution Model May Actually Reduce Competition in the Market

The Proposal would amend Rule 6c-10(c) and make it possible for funds and broker-dealers to offer an alternative distribution model to consumers by exempting broker-dealers from section 22(d) of the Investment Company Act ("the Act"). Section 22(d) requires broker-dealers to follow uniform pricing schedules. The NPRM would allow the distributor or financial intermediary to set their own pricing schedule for certain share classes.

The Roundtable firmly supports open and fair competition in the markets but we are concerned about the legal and operational implications of the Commission's proposal. Section 22(d) effectively allows mutual funds to control their distribution, and ensures that consumers can rely on a fund's prospectus as an accurate representation of fees. We are concerned that the benefit of the rule to investors would be illusory and investors will no longer be able to rely on a set price schedule disclosed in the prospectus.

We also believe the exemption may generate an unintended result: instead of creating competition in the market, we think the exemption creates a risk of reduced competition between firms, as large firms slash prices to drive out small and medium sized firms from the business. The ultimate result is less consumer choice. We think investors are best served by the retention of the Investment Company Act.

We also request that the Commission provide additional clarification on the proposed exemption. We are aware that Section 6(c) gives the Commission the authority to adopt rules exempting persons or transactions from the Act, so long as the exemption is (i) necessary, or appropriate in the public interest, and (ii) consistent with the protection of investors and purpose of the Act. On the other hand, Rule 6c-10(c) is arguably inconsistent with section 22(d), because Rule 6c-10(c) would exempt broker-dealers from complying with section 22(d)'s explicit distribution rules. Because the language in section 22(d) is unambiguous, it would be helpful if the Commission could provide further analysis on the basis for the proposed exemption.

VI. Fee reform should be part of comprehensive regulatory reform

We respectfully request that the Commission consider 12b-1 reform in context with the ongoing Dodd-Frank regulatory reform requirements. We understand the Commission has been considering 12b-1 fee reform for several years and we appreciate the sense of urgency. However, we think investors would benefit from a comprehensive reform of mutual fund fees that considered the relationship between mutual fund fee reform and other pending reform efforts. Pending rulemakings on point-of-sale disclosure, the harmonization of broker-dealer and investment advisors fiduciary duties, the Department of Labor's revised definition of "fiduciary", and new disclosure rules, and ERISA regulations could have a significant impact on the retail mutual fund market. Mutual fund fee reform should not occur in a silo when so many other important regulatory changes are underway.

Conclusion.

While the Roundtable supports the Commission's goal of ensuring that investors receive clear information about financial products, we urge the Commission to carefully weigh the impact of the Proposal on retirement plans, sweep accounts, insurance products, and small funds, and exempt those funds from the scope of the Proposal. Thank you for your time and consideration of our comments. Please feel free to contact me at Rich@fsround.org, or the

Roundtable's Senior Regulatory Counsel, Brad Ipema, at Brad.Ipema@fsround.org if you have any questions about out comments.

Best Regards,

Richard M. Whiting

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