

# National Association of Personal Financial Advisors

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*Via Electronic Filing*

November 5, 2010

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

Re: Mutual Fund Distributions Fees; Confirmation

**File Number S7-15-10**

Dear Ms. Murphy:

The National Association of Personal Financial Advisors (NAPFA)<sup>1</sup>, the nation's leading organization of Fee-Only comprehensive financial advisors, is please to comment on 12b-1 fees and their impact on American investors.

NAPFA's Concern Regarding Fund Director Oversight of 12b-1 Fees. Rule 12b-1(e) the rule requires directors (including a majority of the independent directors) to conclude, in exercising their reasonable business judgment and in light of their fiduciary duties, that there is a reasonable likelihood that the 12b-1 fee arrangement will benefit both the fund and its shareholders. NAPFA is concerned that directors have not properly fulfilled their fiduciary duty on behalf of fund shareholders, with regard to the amount of 12b-1 fees charged and determining that such fees benefit not only the fund but also its existing shareholders. In particular, we note that few funds appear to quantify the administrative fee savings of a fund which might arise from distribution through brokerage firm channels. The maximum level of the 12b-1 "service fee" often far exceeds any cost savings to the fund itself. Such cost savings

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<sup>1</sup> The National Association of Personal Financial Advisors is the nation's leading organization of Fee-Only comprehensive financial planning professionals. Since 1983, NAPFA's members have operated under a strict Code of Ethics, with each member adopting a Fiduciary Oath and adhering to our widely recognized definition of Fee-Only compensation. NAPFA members are trusted, objective financial advisors for consumers and institutions alike. NAPFA's 1,400+ NAPFA-Registered Financial Advisors are all registered as investment adviser representatives of registered investment advisory firms or as RIAs, and each one believes that bona fide fiduciary standard of conduct is vital to ensuring that the best interests of the client remains paramount at all times during the course of the advisor-client relationship.

could accrue from a shifting of the burden of delivery of shareholder information and reports, including tax reporting, to the brokerage firm.

Moreover, NAPFA does not believe that 12b-1 fees should be utilized to support marketing activities engaged in by broker-dealer firms, as fund shareholders – including those not served by broker-dealers – bear such costs. There is no evidence of any material benefit accruing to fund shareholders from the marketing activities of broker-dealer firms.

In summary, we believe that a fund’s Board should be called upon to quantify the cost savings accruing to fund shareholders by the administrative services provided by broker-dealer firms, as to how much such administrative services relieve the fund shareholders’ of administrative cost burdens. The maximum amount of the “service fee” should be tied to these quantified cost savings. In no event, however, should fund shareholder assets be utilized to pay for broker-dealer marketing activities.

NAPFA’s Concern Over Improper Use of “Service Fees” – “Special Compensation.” NAPFA remains concerned that even the “service fee” portion of the 12b-1 fee is being used improperly for the delivery of investment advice. Under NASD Conduct Rule 2830(d)(5) “service fees” were defined as “payments by [a fund] for personal service and/or the maintenance of shareholder accounts.” NASD Conduct Rule 2830(b)(9). These services could include responding to customer inquiries, providing information on investments, and *reviewing customer holdings on a regular basis*. NAPFA submits that the review, with the customer, of the customer’s holdings - on a regular basis - falls outside of the “solely incidental” exclusion from the definition of investment adviser, and moreover constitutes “special compensation.” Numerous comments received by the Commission provide evidence that the “service fees” are being utilized as special compensation for ongoing investment advice which is not solely incidental to the sale of the fund’s shares. Accordingly, those broker-dealers and their registered representatives who receive “service fees” as a means of facilitating review of the customer’s investments, with the customer, should be registered under the Advisers Act, and should adhere to the fiduciary duties and other requirements of the Advisers Act.

NAPFA’s Concern Over the “Sales Charge” as “Special Compensation.” Under the Commission’s proposed rule amendment, a fund imposing an ongoing sales charge would be required to automatically convert fund shares to a class of shares without an ongoing sales charge no later than when the investor has paid cumulative charges that approximate the amount the investor otherwise would have paid through a traditional front-end load (or, if none, the NASD rule 6.25 percent cap). Moreover, the cumulative amount of sales charges the investor pays on any purchase of fund shares should not exceed the amount of the highest front-end load that the investor would have paid had the investor invested in another class of shares of the same fund.

NAPFA notes, however, that should a fund shareholder redeem his or her shares in the fund prior to the date of conversion to a class of shares without an ongoing sales charge, the maximum sales charge is never received by the broker-dealer. This is wholly unlike Class B mutual fund shares, in which a surrender fee supports payment (often up-front, and in full) of the commission to the broker-dealer firm, should the shareholder redeem prior to a specified time period. Accordingly, while called an “asset-based sales charge,” the “sales charge” still appears to not bear the true characteristics of commission-based compensation.

As the Commission notes in its release, many commentators have asserted that “12b-1 fees associated with level load funds (often 100 basis points) pay for valuable ongoing investment advice provided by the intermediary.” Many of the additional comments received from registered representatives provide additional ample evidence of this use of 12b-1 fees – to provide ongoing investment advice. However, intermediaries that are broker-dealers are excluded from the definition of investment adviser under the Advisers Act with respect to advice they provide that is “solely incidental to the conduct of [their] business as a broker or dealer” and for which they receive “no special compensation.” Section 202(a)(11)(C) of the Advisers Act [15 USC 80b-2(a)(11)(C)]. NAPFA believes that the Commission’s effort to limit the time over which the “sales charge” is paid will not eliminate the widespread practice of delivering ongoing investment advice to a customer of a broker-dealer. Hence, in many, if not most, instances, receipt by the broker-dealer of 12b-1 fees will continue to constitute “special compensation.”

“Sales Charges” Will Result in Many Investors Paying Higher Fees; At a Minimum, Require Disclosure of These Higher Payments to Broker-Dealers. NAPFA notes that since the “sales charge” is paid each year, and is tied to the amount of the fund assets, and since the value of fund shares can be expected to rise over time, the total amount of the “sales charge” paid is likely, the vast majority of the time, to exceed the up-front sales load. Hence, NAPFA does not believe that the sales charge limitations, as the Commission proposes to apply them, adequately protect investors from excessive sales loads. Should the Commission proceed with this proposal, NAPFA suggests that the Commission, at a minimum, require prominent up-front disclosures of this fact to customers of broker-dealer firms. This may result in many customers opting for payment of sales loads, instead.

“Switching” Concerns. NAPFA members continue to observe that many registered representatives and their broker-dealer firms, in connection with variable annuity sales, continue to engage in sales of new variable annuities, with commissions paid and/or higher trail fees, once the surrender fee on the old variable annuity product has expired. Despite regulatory efforts to curtail such practices, they persist in widespread fashion, often under the guise that the new product offers some additional or different “guarantee” or other feature favorable to the investor. In reality, the reason for such a “switch” is to afford more compensation to the broker-dealer firm.

NAPFA believes that the expiration of the sales charge will lead to many broker-dealers to recommend “switching” between fund families once an investor has reached the ongoing sale charge limits. Rather than reduce conflicts of interest between brokers and their customers, this new rule will lead to greater conflicts of interest.

Repeal 12b-1 Fees, Altogether. For the foregoing reasons, while we applaud the Commission’s efforts to reign in the many abuses in this area, NAPFA believes that individual investors would best be served by a full repeal of 12b-1 fees, with no replacement rule in their place.

The National Association of Personal Financial Advisors and its members have, for over a quarter of a century, provided leadership in the adoption of the fiduciary principal to the investment and financial advisory activities of its members. We stand ready to assist the Commission, at any time, as it considers the reform or elimination of 12b-1 fees.

Yours truly,

Susan MacMichael John, CFP®  
Chair, NAPFA

Ellen Turf  
CEO, NAPFA

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Chair, Industry Issues Committee

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## National Association of Personal Financial Advisors' Fiduciary Oath

- The advisor shall exercise his/her best efforts to act in good faith and in the best interests of the client.
- The advisor shall provide written disclosure to the client prior to the engagement of the advisor, and thereafter throughout the term of the engagement, of any conflicts of interest, which will or reasonably may compromise the impartiality or independence of the advisor.
- The advisor, or any party in which the advisor has a financial interest, does not receive any compensation or other remuneration that is contingent on any client's purchase or sale of a financial product.
- The advisor does not receive a fee or other compensation from another party based on the referral of a client or the client's business.

## NAPFA Code of Ethics

**Objectivity:** NAPFA members strive to be as unbiased as possible in providing advice to clients and NAPFA members practice on a fee-only basis.

**Confidentiality:** NAPFA members shall keep all client data private unless authorization is received from the client to share it. NAPFA members shall treat all documents with care and take care when disposing of them. Relations with clients shall be kept private.

**Competence:** NAPFA members shall strive to maintain a high level of knowledge and ability. Members shall attain continuing education at least at the minimum level required by NAPFA. Members shall not provide advice in areas where they are not capable.

**Fairness & Suitability:** Dealings and recommendation with clients will always be in the client's best interests. NAPFA members put their clients first.

**Integrity & Honesty:** NAPFA members will endeavor to always take the high road and to be ever mindful of the potential for misunderstanding that can accrue in normal human interactions. NAPFA members will be diligent to keep actions and reactions so far above board that a thinking client, or other professional, would not doubt intentions. In all actions, NAPFA members should be mindful that in addition to serving our clients, we are about the business of building a profession and our actions should reflect this.

**Regulatory Compliance:** NAPFA members will strive to maintain conformity with legal regulations.

**Full Disclosure:** NAPFA members shall fully describe method of compensation and potential conflicts of interest to clients and also specify the total cost of investments.

**Professionalism:** NAPFA members shall conduct themselves in a way that would be a credit to NAPFA at all times. NAPFA membership involves integrity, honest treatment of clients, and treating people with respect.