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November 8, 2010

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

Re: File No. S7-15-10
Request for Comment –
Mutual Fund Distribution Fees

Dear Ms. Murphy:

Prudential Investments, LLC ("PI") submits this letter in response to the request of the Securities and Exchange Commission's (the "Commission" or "SEC") in Release IC-29367 (July 21, 2010) (the "Proposing Release") for comments on proposed Rule 12b-2 under the Investment Company Act of 1940 (the "Investment Company Act") that is designed to replace Rule 12b-1 under the Investment Company Act. PI and its predecessors have served as a manager or administrator to investment companies since 1987. As of September 30, 2010, PI, a wholly-owned subsidiary of Prudential Financial, Inc. ("Prudential"), served as the investment manager to all of the Prudential U.S. and offshore open-end investment companies, and as the manager or administrator to closed-end investment companies, with aggregate assets of approximately $133.2 billion.

Rule 12b-1 is an integral part of the structure and strength of the mutual fund industry. The rule and its associated fees allow investors to pay distribution costs over time, to access funds that otherwise might not be available to them, and to compensate financial intermediaries, on whom so many fund investors depend. Accordingly, this rulemaking is of critical importance to the fund industry and its millions of investors. As a member of the Investment Company Institute, PI participated in the preparation of the letter submitted by the Investment Company Institute relating to the Proposing Release and PI would like to emphasize its concurrence with the following views that were expressed in that letter.

COMMENTS

A. Timing of Proposal

The SEC is currently in the midst of a major study on the effectiveness of existing legal and regulatory standards of care for brokers, dealers, investment advisers, and their respective associated persons.[1] The SEC is undertaking that review in the context of personalized investment advice and recommendations about securities to investors, and evaluating whether there are gaps, shortcomings, or overlaps in the current legal or regulatory standards of care applicable to these intermediaries.

Prudential believes that the SEC should complete its thoughtful and diligent study of broker, dealer and investment adviser standards of care and delay its Rule 12b-1 reform efforts until, pursuant to Section 913 of Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"),[2] any changes to standards of conduct and point of sale disclosures have been adopted.

Certain elements of the confirmation statement disclosure proposed as part of this 12b-1 rulemaking would clearly be more appropriate for a point of sale disclosure document. Confirms should serve as a record of a transaction and allow the investor to verify that the transaction was processed correctly and that whatever fees are associated with the transaction were properly assessed. Point of sale disclosure, in contrast, is meant to provide the investor with certain key information that highlights potential conflicts that he or she should consider *before* making the investment decision. As the SEC itself recognizes, confirms cannot do this - "[i]n making this proposal, we are mindful that...customers do not receive confirmations until after completing their purchases of mutual funds."[3] The SEC has legitimate concerns over the potential conflicts of interest a broker may have in recommending a particular investment or share class to an investor. We do not believe that the confirm is the appropriate means to convey this information.

B. Importance of a Robust Economic Analysis

A comprehensive economic analysis is especially critical in this rulemaking given the significant benefits Rule 12b-1 has provided to fund investors. A majority of funds today use 12b-1 fees to defray distribution-related costs and the fees are deeply embedded within the fund distribution infrastructure. Ill-designed changes to the rule risk confusing or displacing investors, removing important channels of information for investors, disturbing a robust and well-functioning market for mutual funds, and impairing market efficiency and competition.

We are concerned that the SEC has not given sufficient consideration to the potential impacts of

[1] *See Study Regarding Obligations of Brokers, Dealers, and Investment Advisers*, SEC Release Nos. 34-62577 and IA-3058 (July 27, 2010), available on the SEC's website at http://sec.gov/rules/other/2010/34-62577.pdf (the "IA-BD Study").
[2] Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat. 1376 (2010).
[3] Proposing Release at 68.

its proposal. As required by statute, the SEC must weigh the anticipated benefits of a rulemaking against any resulting costs and burdens for investment companies generally and small funds in particular.[4] The United States Court of Appeals for the District of Columbia Circuit has repeatedly emphasized the importance of the SEC's consideration of the costs regulated entities would incur in order to comply with a rule.[5] The proposal entails major changes to the distribution system for mutual funds. It is incumbent on the SEC to ensure that the benefits of such changes to the public and investors outweigh the costs. We encourage the SEC to obtain and review additional information about the economics of mutual fund distribution and impacts on all participants before proceeding with tit rulemaking to drastically alter the regulatory framework.

C. Ongoing Sales Charges and the "Functional Equivalence" of 12b-1 Fees to Upfront Sales Charges

The proposal would allow funds to impose "ongoing sales charges" up to a reference load. The central concept underlying much of this part of the proposal is that a portion of what is currently paid for with 12b-1 fees is the functional equivalent, paid over time, of a front-end sales load, and thus should be subject to the requirements and limitations that apply to traditional front-end sales loads.[6] However, the proposal itself is far broader. It would apply to any context in which a current 12b-1 fee exceeds 25 basis points, including in many contexts where the use of the fee is quite clearly not an alternative to a front-end sales charge. In addition to providing a way to create a substitute for a front-end sales charge, Rule 12b-1 has allowed funds to tailor various classes to reflect the economics and pricing necessary in different contexts. This has broadened the payment options available to investors for distribution and shareholder services, as funds have created share classes with fees that reflect the different services investors receive through a particular channel.[7] In those instances, a hard cap on aggregate compensation is not warranted. The services in those instances will have to continue; the compensation must as well.

The SEC has requested comment on the potential consequences of this proposal in

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[4] As the Release indicates at 241, the SEC is required to consider the impact that a proposal would have on competition, and is prohibited from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Securities Exchange Act. *See* Section 23(a)(2) of the Securities Exchange Act. The Commission also must consider, "in addition to the protection of investors, whether [the rule proposal] will promote efficiency, competition and capital formation." *See* Section 3(f) of the Securities Exchange Act and Section 2(c) of the Investment Company Act.

[5] *See Chamber of Commerce v. Securities and Exchange Commission,* 412 F.3d 133, 144 (June 21, 2005) ("uncertainty...does not excuse the Commission from its statutory obligation to do what it can to apprise itself-and hence the public and the Congress-of the economic consequences of a proposed regulation before it decides whether to adopt the measure."); *American Equity Investment Life Insurance Company v. Securities and Exchange* Commission, Case No. 09-1021 (July 21, 2009) (finding that the SEC's analysis of effects on efficiency, competition, and capital formation in adoption of rules related to indexed annuities was arbitrary and capricious, and remanding the matter to the Commission for reconsideration). Another SEC rule is currently being challenged as arbitrary and capricious. *See Business Roundtable et al. v. Securities and Exchange Commission*, United States Court of Appeals for the District of Columbia Circuit, Docket # 10-1305 (filed Sept. 29, 2010).

[6] Proposing Release at 37.

[7] For a description of the benefits that Rule 12b-1 has provided, *see* 2007 ICI Roundtable Submission.

connection with fund shares used with retirement plans."[8] We believe that the ongoing services provided in the retirement plan context provide an example of 12b-1 fees that are not the functional equivalent of a front-end sales charge. We request that the SEC re-evaluate the applicability of Rule 12b-2 to share classes used with retirement plans, particularly the potential characterization of such fees as ongoing sales charges subject to a cap and share class conversion. While the SEC notes that 12b-1 fees are often used to pay for participant and shareholder servicing in connection with retirement plans,[9] its subsequent discussion of R shares casts considerable doubt on the feasibility of this structure going forward.[10] Accordingly, we strongly recommend that the final rule address these concerns by either: (a) providing an exception from the ongoing sales charge limitations of Rule 12b-2 for these share classes; (b) relaxing the limitations imposed on these share classes (including raising the amount of acceptable ongoing charges and removing the requirement to cap such charges and convert shares); or (c) issuing clarifying guidance permitting funds to compensate for services provided to retirement plans and plan participants without having to treat such compensation as an ongoing sales charge.

The SEC also requested comment on whether the rule instead should treat the FINRA sales charge limit of 6.25 percent as the reference load for purposes of determining the maximum amount of ongoing sales charge in all cases, even if a fund has a front-end load class of shares that can serve as the reference load.[11] We strongly favor this approach, for all of the reasons described in the letter submitted by the Investment Company Institute. We especially would like to point out our concern that without a uniform reference load the array of conversion schedules and dates could easily become so confusing to investors and challenging for intermediaries to manage as to discourage the future use of certain share classes. Additionally, the uniform reference load would eliminate any interpretive questions that arise with the standard as proposed. For example, it is not entirely clear whether the SEC intended reference loads to be calculated with regard to breakpoint discounts. The Proposing Release explains that the reference load would "be the highest front-end load of another class of that fund that does not charge an ongoing sales charge,"[12] suggesting that breakpoint discounts are to be disregarded. But the proposed rule states that the reference load is "the highest sales load rate that the shareholder would have paid." Similarly, it is not clear how to apply the proposed rule in contexts where a particular type of purchaser only qualifies for a particular class (*e.g.*, retirement plans and retirement shares). The proposed rule is clear that the reference load is derived from a class "for which the shareholder qualifies." Does that mean that all classes used exclusively for one type of investor always utilize a reference load of 6.25 percent, because that type of investor would not qualify for other classes? A uniform reference load would be simple, clear, and completely objective.

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[8] See Proposing Release at 131.
[9] See Proposing Release at 28.
[10] See Proposing Release at 131.
[11] Release at 58.
[12] Release at 53.

D. Reinvested Dividends and Distributions

The proposal would permit the reinvestment of dividends and distributions in a share class with an ongoing sales charge, subject to the same conversion schedule as the shares on which the dividend or distribution was declared.[13] While this model may be attractive conceptually, as the original purchase and all related reinvested dividends and distributions would convert at the same time, it is nearly unworkable in practice. A simple example illustrates the problem. Assume an investor has amassed $20,000 in an account through systematic investments in a bond fund that has a current annualized yield of 4 percent and that the fund pays a current monthly dividend of $66.67.[14] The proposal assumes that the fund will allocate portions of that $66.67 dividend to the potentially hundreds of original purchase lots, including, for example, allocating approximately twenty two cents to the shares purchased with the prior month's reinvested dividends.[15]

This type of allocation requirement will exponentially increase the number of share lots to be converted. As a result, the conversion process would be complex to program, difficult to recordkeep and would lead to reconciliation and breakage issues because of rounding conventions and systems limitations. Additionally, for cross dividend reinvestment transactions[16] or for partial exchange transactions,[17] it would be impossible to program to allocate dividend and distributions to original purchase lots. In both instances multiple CUSIPs or share classes are affected, and the detailed account history for the shares on which the reinvested dividends and distributions were paid would not be accessible for use in the allocation process proposed by the SEC.

We strongly recommend that the final rule permit funds to treat dividend and distribution reinvestments as a single lot (or bucket) that would convert proportionately based on the total shares held in an account at the next scheduled periodic (*e.g.*, quarterly, monthly, weekly) conversion date. This approach will be far easier to program and administer, thus avoiding the additional costs for complex programming and to resolve account reconciliation issues that would occur if funds were required to implement the practice as proposed. It serves investor and SEC interests, as investors will not pay ongoing sales charges on reinvested shares longer than they hold invested shares. And it is consistent with the way B share conversions work today.

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[13] See Proposing Release at 61.

[14] $20,000 * 4% yield=$800/12 months=$66.67.

[15] $66.67*4% yield=$2.67/12 months=0.22.

[16] Where the reinvestment dollars are used to purchase shares in another CUSIP or share class.

[17] Where only a portion of the shares in an account are exchanged into another CUSIP or share class.

E. Disclosure Amendments; Confirms

The proposal includes a number of new disclosure requirements in fund prospectuses, annual and semi-annual reports to shareholders, and investor confirmation statements ("confirms") that are intended to "help investors make better-informed choices when selecting a fund that imposes sales charges."[18] While we very strongly support changes that would improve investor understanding of distribution-related fees and expenses, we are concerned that some of the proposed confirm disclosure is unnecessary and may have the unintended consequence of complicating the confirm to the extent that brokers are encouraged to sell other products not subject to the same requirements.

Under the proposal, confirms would be required to include the amount of any sales charge that the customer incurred at the time of purchase, in percentage and dollar terms, along with the net dollar amount invested and the amount of any applicable breakpoint or similar threshold used to calculate the sales charge. In addition, confirms would have to include, if applicable: the annual amount of any marketing and service fee; the annual amount of any ongoing sales charge; the aggregate amount of the ongoing sales charge that may be incurred over time, expressed as a percentage of net asset value; and the maximum number of months or years that the customer will incur the ongoing sales charge. Confirms would also have to include a standardized statement warning investors that there are additional asset-based fees and other expenses explained in the fund's prospectus.

Confirms are not point of sale disclosure documents, nor are they prospectuses. Confirms are, by their very nature, post-sale documents intended to establish a record of the transaction and allow investors to verify information. The information proposed to be included that relates to charges incurred at the time of purchase is important information for these purposes. Forward-looking information about marketing and service fees and ongoing sales charges, however, is not. That information is certainly appropriate for a prospectus, and may be appropriate for a point of sale document. Requiring it in a confirm as well would be redundant, and would run the risk of cluttering the confirm and obscuring the transaction information that the confirm is meant to convey. Additionally, confirm changes can be operationally difficult and costly to implement.[19]

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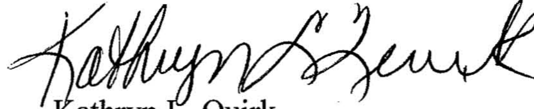
[18] Release at 1. The new disclosure requirements also apply to the alternative periodic reporting provisions of Rule 10b-10(b), which in part permit quarterly reporting for transactions involving investment company plans. *See* Release at 71 and n.231.

[19] The SEC is well aware of the operational difficulties with implementing confirm changes. It proposed confirm and point of sale disclosure changes in 2004 that drew over five thousand comments. *See* SEC Release No. 34-49148 (January 29, 2004), 69 FR 6438 (February 10, 2004). The SEC reopened the comment period in 2005 with a supplemental proposal that included over 300 additional questions. *See* SEC Release No. 34-51274 (Feb. 28, 2005), 70 Fed. Reg. 10521 (Mar. 4, 2005). This process vividly illustrated how numerous and difficult the issues are with confirm and point of sale disclosure proposals.

We appreciate the SEC's consideration of our comments. If you have any question s or need additional information, please contact the undersigned at (973)367-7525 or Claudia DiGiacomo at (973) 802-5032.

Sincerely,



Kathryn L. Quirk
Chief Legal Officer and
Executive Vice President of
Prudential Investments, LLC

cc: The Honorable Mary L. Schapiro
The Honorable Kathleen L. Casey
The Honorable Elisse B. Walter
The Honorable Luis A. Aguilar
The Honorable Troy A. Paredes

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