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

On July 21, 2010, the SEC proposed changing how fees charged by mutual funds are regulated. While well intentioned, we question if the SEC is overstepping its goal of protecting the public with attempting to fix prices.

As both an independent broker/dealer and an investment advisor, we feel we may see this issue from a broader somewhat unique prospective.

As is stated by the SEC in its release, 12b-1 fees were developed in the 1970s to help mutual funds pay for marketing expenses. Since the '70s, these fees have grown from the millions to nearly $10 billion. The release acknowledges investors are unclear about these charges and, by limiting these fees to a maximum, seeks to protect investors from an abuse of continuing fees. While some may applaud this stance, we should step back to look at the investment industry before passing such quick judgment.

Broker/dealers, through their licensed representatives (registered reps), distribute mutual funds as well as other investments to their clients. They are bound to a suitability standard to know their customer's goals and needs prior to recommending an investment. While some may look to judge the honesty of these services, let's review the floor that has been set for the industry. To become a representative, one must pass some exams (generally Series 6 or 7) and have a clear record in regard to criminal activities. While headlines are often made, it is obvious the majority of brokers look to make an honest living with their clients. Another view of the investment business comes from Investment Advisors.

Investment Advisors, through their licensed representatives (IARs), distribute "advice" for, in most cases, a fee. These advisors must offer a higher degree of disclosure to their clients but, in general, are not limited in their ongoing fees. The thought is that clients receive ongoing advice and pay fees for that advice.

No doubt, these explanations are completely clear. Clear, that is, until the consumer visits or calls the office of the broker or advisor. What is obvious to the industry, is the true lack of clarity in defining the two separate methods of distributing services and products to the public.

Since the 1970s, broker dealers, through their representatives, have created annuities of income by selling mutual funds offering ongoing annual fees. The fees are disclosed in the prospectuses distributed with the mutual funds. But, who really reads the prospectus? We'd like to say everyone but realities are, few. So, when an investor discovers the fees have gone on for many years, shouldn't they be concerned? Absolutely – that is unless they understood at the beginning they invested into funds with the 12b-1 fees.

What should be obvious is the investing public should always be allowed to choose what costs are worthwhile to pay for services that are received. For those of us who have bought an appliance recently, did you choose the lowest price, possibly buying that new refrigerator over the internet? Or, did you consider purchasing at your local appliance store and paying a premium to deal with a knowledgeable salesperson? Did the salesperson offer ongoing service for an ongoing price?

For those who disagree with the above analogy, let's go right to mutual funds. Yes, funds can be purchased for no loads. Yet, some investors may, if given the choice, purchase those mutual funds through a licensed salesperson. If the salesperson offered a cost up front or an ongoing fee, what would you choose? Better yet, would you rather someone unrelated to your transaction make that decision for you?

If we change the above to an investment advisor representative, the picture would look much the same. Yes, investors can create their own portfolios of stocks and mutual funds. Or, they can pay an advisor to do this for them. The fee? An ongoing charge, forever. In both cases above, the fee is disclosed. However, in the 12b-1 case, just when prospectuses are sent to clients. In the case of investment advisors, calculations of fees are disclosed each time a fee is assessed.

Let's examine the SEC's proposal which looks to accomplish four objectives:

1) **Protect investors by limiting fund sales charges.**
   This is a noble cause. Stop the charges before they get too high. Most of the 12b-1 fees now charge approximately 1% or less annual for fees. These fees are assigned to a share class often known as the C class. With representatives receiving a portion of this 1% (shared with their broker/dealer), the desire to switch clients to other investments is, no doubt, less attractive. While the C class share may have originally been meant to support distribution costs, today the C class share seems more like an investment advisory fee. Remember, investment advisors are able to charge a fee (1% is not unusual) forever based on the value of a client's investment. We must question the wisdom of the SEC's goal of protecting investors. If so, why not limit an advisor's overall fees over time. The answer is simple – brokers and advisors tend to do little for their clients, over time, if there is no economic benefit. An advisors fee provides that ongoing economic benefit. Likewise, a 12b-1 charge offers a broker that same economic benefit. For those who say brokers do not earn that ongoing fee, it seems simple. Clients who do not receive services leave their brokers, as well as their advisors. Indeed, this is what competition is all about. A client who does not want to pay a broker or advisor can simply call or walk into a no-load mutual fund firm. Is it

the goal of this proposal to restrict advice that investors might otherwise choose? The eventual result of restricting brokers will be to simply push brokers to an investment advisor method of doing business. Will the public notice? Unlikely – other than viewing more disclosure.

2) **Improve transparency of fees for investors.**
This is likely the key issue of this proposal. Say the term 12b-1 to an investor and they most often glaze over. Say annual fee and they get it. Put the fee (bury the fee) into a prospectus and investors will miss it. Put the fee on each statement, similar to investment advisors and they would get it. So, why is this proposal looking to limit fees compared to simply improving the disclosure of those fees? The result of the fee limitation would be mostly, anti-competitive. Again, a consumer's ability to choose to work with a broker representative or an investment advisor should be their own. And, limiting pricing could only limit advice that broker representative would be looking to provide. The better solution would be to level the disclosure field.

3) **Encourage retail price competition.**
Limiting compensation does not create competition. Competition is meant to be a contest. The contest has a winner and a loser. The competitors determine their own fate by offering better pricing, servicing and care for their clients. Limiting any part of this equation allows the referee to try to control the contest. Yet, the referee should have no direct interest in the final outcome. For clients who wish to obtain a specific advisor or broker's ideas or advice, they may choose to pay for it. Perhaps some may choose an advisor with the knowledge that they will help them with choices and try to know them better than a lower priced alternative, perhaps 1000 miles away by phone. Competition is a dynamic puzzle. If not, why would people shop at so many stores to buy the exact same commodities such as cars? Some may choose based on a free weekly car wash, others for a loaner car and others based solely on price. Limiting the dealer's profit rather than letting consumers make the choice would certainly be anti-competitive. In today's market, mutual funds are allowed to choose their own individualized fee/compensation schedules.

Brokers who choose to work with the fund families do so of their own choice. Forcing mutual funds to allow their end users to determine pricing (similar to MSRP) would seem to be unneeded. Perhaps allowing brokerage firms the ability to waive fees, similar to investment advisors today, may be a better approach. Remember, advisors are allowed to charge fees, forever, based on a client's assets. However, it is generally accepted that an advisor, helping a client to buy a mutual fund with commissions (loads), would be double-dipping, a taking of both fees and commissions. With this in mind, most advisors take advantage of mutual funds' offer to let them waive the broker compensation. The result is a no-load mutual fund with ongoing investment advisor fees. For retail clients, this event can be very confusing.

4) **Revise fund director oversight duties.**
From the top, the SEC has proposed something that is not right. Is this the lawyers in the room or for the better of investors? Perhaps giving investors more views into the boardroom would be more appropriate. As with 1,2 and 3 above,

disclosure seems to be the more effective route compared to more rules and regulations. An assumption is fund directors have little time to give to their funds since so much time is spent on approving distribution financing plans. These approvals are part of a mutual fund's annual meetings and are not considered, as the proposal would intimate, onerous. Changing the rule by fixing the pricing industry-wide would seem to put the regulators' goals ahead of investors' rights to choose.

Our position on the objectives from the SEC, to protect the public by controlling pricing and competition, is that these moves would likely push the industry to further consolidate towards advisory relationships. Advisory relationships, with ongoing fees, that may cost clients even more than they are accustomed to now. Yet, without changing any rules, 12b-1 fees are already moving the industry closer to this end result.

With the SEC goal to protect investors, a better solution would be to simply improve broker disclosure. The model already exists – the investment advisor model. Clients who wish to maintain their relationships with brokers rather than advisors need make no changes. For those looking for a lower cost approach, that's what competition is all about. Let the no loads continue to compete with the load funds. And, let the no-load brokers and no-load advisors compete as well. Let's level the playing field so clients are better able to easily see what they are paying. Then, the referee should stand back and let the contest continue.

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