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**Elizabeth Murphy, Secretary**
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 205549-1090

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**Re: Proposed Changes to Mutual Fund Distribution Fee Rules; Proposed Rule 12b-2**

The American Society of Pension Professionals and Actuaries (ASPPA) and the Council of Independent 401(k) Recordkeepers (CIKR) appreciate the opportunity to comment on proposed modifications to regulations regarding the use of mutual fund assets to pay the costs of promoting the sale of mutual fund shares.[1]

ASPPA is a national organization of more than 7,000 retirement plan professionals who provide consulting and administrative services for qualified retirement plans covering millions of American workers. ASPPA members are retirement professionals of all disciplines including consultants, administrators, actuaries, accountants, and attorneys. The large and broad-based ASPPA membership gives it unusual insight into current applications of the rules affecting mutual fund investment practices in the retirement, pension, and profit-sharing plan context. ASPPA is particularly focused on the issues faced by small- to medium-sized employers. ASPPA membership is diverse and united by a common dedication to the private retirement plan system.

CIKR is a national organization of 401(k) plan service providers. CIKR members are unique in that they are primarily in the business of providing retirement plan services as compared to financial services companies who primarily are in the business of selling investments. The independent members of CIKR offer plan sponsors and participants a wide variety of investment options from various financial services companies without an inherent conflict of interest. By focusing their businesses on efficient retirement plan operations and innovative plan sponsor and participant services, CIKR members are a significant and important segment of the retirement plan service provider marketplace. Collectively, the members of CIKR provide services to approximately 68,000 plans covering 2.8 million participants and holding in excess of $120 billion in assets

[1] Mutual Fund Distribution Fees; Confirmations, 75 Fed. Reg. 47064 (Aug. 4, 2010)(to be codified at 17 C.F.R pts. 210, 239, 240, 270, 274).

## Summary

ASPPA supports the Commission's effort to protect individual investors from paying excessive sales charges and promoting investor understanding of mutual fund fees by proposing to replace Rule 12b-1, which has permitted mutual funds to use fund assets to pay for the costs of promoting sales of mutual funds. ASPPA also appreciates that, in proposing a new regulatory framework to replace Rule 12b-1, the Commission has considered the potential impact on retirement and other employee benefit plans, which currently invest over $4 trillion in mutual funds.[2] As the Commission recognizes, 12b-1 fees play a significant role in the retirement plan services industry by paying for necessary services provided to retirement plans investing in mutual funds, including recordkeeping, plan administration and other related services. The role played by 12b-1 fees is especially important for the more than 350,000 participant-directed 401(k) and similar retirement plans sponsored by small business.[3] For example, in the case of one plan services provider to approximately 8,500 plans with an average size of 17 participants, almost half of the mutual fund investment options offered in these plans have 12b-1 fees in excess of 25 basis points, and 35 percent of plan assets are held in these investments.

It is critical that a new framework replacing Rule 12b-1 does not unnecessarily impose new and burdensome costs, disrupt services to retirement plans, or make mutual funds less competitive with insurance and other investment products offered to retirement plans. To avoid such disruption and costs, and to ensure that mutual funds remain competitive, ASPPA respectfully requests that the Commission consider the following.

- *Provide a Plan Investor "Safe Harbor."* The Commission should further amend Rule 6c-10 to include a "safe harbor" under which mutual funds need not convert a participant in a participant-directed plan (a "plan investor") to a share class with no ongoing sales charges, if the plan investor invests in a share class with an ongoing sales charge set at a rate such that the conversion period would be at least 15 years (or 180 months).

- *Permit Transition of Plan Investors to "Safe Harbor" Shares.* Transition rules should permit plan investors to be converted to a share class with an ongoing sales charge that satisfies the proposed safe harbor, rather than requiring conversion to a class with no ongoing sales charge.

- *Extend Proposed Compliance Period, if Plan Investor Safe Harbor is not Adopted.* If the Commission does not provide the proposed safe harbor for ongoing sales charges applicable to plan investors, the "compliance period" for making changes to comply

[2] Investment Company Institute, The U.S. Retirement Market 2009, 40 (May 2010).
[3] As reported by the U.S. Department of Labor based on 2007 Form 5500 reports, more than 350,000 401(k) and similar plans that allow participant direction of the investment of some or all plan assets are reported to have fewer than 100 participants (compared to an approximate total 430,000 401(k) type plans that allow participant direction of some or all plan assets). These small plans have about 8 million participants. U.S. Department of Labor, Employee Benefits Security Administration, Abstract of 2007 Form 5500 Annual Reports, Table D6(b), Number of 401(k) Type Plans and Active Participants (June 2010).

with the proposed rules should be extended to end 36 months after the amended regulations are adopted, in light of difficulty and costs to modify plan recordkeeping systems that would imposed on plan recordkeepers and administrators.

- *Preserve Funds' Flexibility to Pay for Plan Administration and Compliance.* It is important to preserve funds' flexibility to pay for services to plan investors, including for administration and other plan compliance services, as well as for distribution services. The Commission (1) should confirm that fees paid from funds for plan administration and compliance activities will not be deemed to finance "distribution activity" under proposed Rule 12b-2, but (2) should not preclude funds from paying for a mix of distribution and administrative services under Rule 12b-2.

- *Discussion of Whether to Address How Plan Investors Use 12b-1 Fees Must Consider Costs of Regulation and be Coordinated with the U.S. Department of Labor.* If the Commission considers rulemaking to address concerns that, in paying for services to plan investors, funds may sometimes pay for services to non-fund investors, ASPPA requests the Commission consider (1) the likely costs of requiring funds to inquire about the use of fees paid for marketing, shareholder services, administration and other services provided to plan investors, and (2) trial rulemaking on this matter must be coordinated with the U.S. Department of Labor ("Labor Department") to avoid potentially significant regulatory inconsistencies.

- *Rule Changes Permitting Account-Level Sales Charges Need Additional Evaluation.* Rule amendments propose to permit fund sales with account-level sales charges. ASPPA members have expressed a wide range of views on the issues raised by the proposed rule. We encourage the SEC to continue to study the potential impact of proposal before proceeding.

We discuss these comments in more detail below.

## I. ASPPA Recommends a Plan Investor "Safe Harbor"

Proposed amendments to Rule 6c-10 would allow mutual funds to pay ongoing sales charges from mutual fund assets in excess of a 25 basis point "marketing and service fee" only if the fund automatically converts investors to a share class without an ongoing sales charge on or before the end of a conversion period, so that the investor does not pay cumulative ongoing sales charges exceeding the amount that the investor would have paid through a traditional front-end load (or if none, the 6.25% cap imposed by current FINRA – formerly, NASD – rules).[4] Because this proposed rule modification will be burdensome and costly for plan investors, may limit the availability of important services that are currently provided to plans, and may make mutual funds less competitive compared to insurance products and other investments, ASPPA requests that the Commission consider adopting a safe harbor from mandatory conversions applicable to plan investors.

[4] Proposed Rule 6c-10(b) and (d)(2), 75 Fed. Reg. at 47135.

Specifically, ASPPA proposes a safe harbor under Rule 6c-10, under which a mutual fund would not be required to convert plan investors to a share class with no ongoing sales charge provided that plan investors are invested in a share class (a "safe harbor share class") with an ongoing sales charge that is set at a rate such that the conversion period would be at least 15 years (or 180 months). For example, a fund with a front-end load set at the 6.25% cap imposed under current FINRA rules could offer a safe harbor share class with an ongoing sales charge no greater than approximately 40 basis points (in addition to the marketing and service fee allowed under proposed Rule 12b-2). For purposes of this safe harbor, the term "plan investors" should include any "plan" that permits participant direction among a range of investment options including one or more mutual funds; and the term "plan" should include: retirement, pension and profit-sharing plans qualified under Internal Revenue Code section 401(a), governmental plans tax-qualified under Code section 457, tax-deferred annuities and other plans established under Code section 403(a) and (b), individual retirement accounts (IRAs), medical savings accounts (MSAs), health savings accounts (HSAs) and education savings accounts. In this regard, the Commission could refer to the definitions of "employee benefit plan account" and "individual retirement account" under Rules 760(h)(4) and (5) of Regulation R.[5]

ASPPA urges the Commission to adopt this safe harbor proposal for the following reasons.

*A. The proposed safe harbor is reasonable because most plan participants are not likely to remain invested in a mutual fund for more than 15 years.*

As the Commission recognizes, recordkeeping systems used in providing retirement plan services do not currently track share lot history,[6] and as a result, tracking systems do not yet exist to provide specific data on how long a participant may stay invested in a particular mutual fund. However, there is a range of data illustrating that the vast majority of plan participants are not likely to remain invested in any mutual fund for as long as 15 years.

- If the plan changes its recordkeeper/investment provider, the participant will exit all of the funds held by the plan. One study indicates that the average relationship between a plan and a provider is 9.2 years; only 8% of plans surveyed exceeded 15-year tenure with a provider.[7]

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[5] Regulation R, Rule 760(h)(4) defines "employee benefit plan account" as a pension plan, retirement plan, profit sharing plan, bonus plan, thrift savings plan, incentive plan, or other similar plan, including, without limitation, an employer-sponsored plan qualified under Code section 401(a), a governmental or other plan described in Code section 457, a tax-deferred plan described in Code section 403(b), a church plan, governmental, multiemployer, or other plan described in Code section 414(d)-(f), an incentive stock option plan described in Code section 422, a Voluntary Employee Beneficiary Association Plan described in Code section 501(c)(9), a non-qualified deferred compensation plan (including a rabbi or secular trust), a supplemental or mirror plan, and a supplemental unemployment benefit plan. Rule 760(h)(5) defines "individual retirement account or similar account" to include an individual retirement account as defined in section 408 of the Code, Roth IRA as defined in section 408A of the Code, heath savings account as defined in section 223(d) of the Code, Archer medical savings account as defined in section 220(d) of the Code, Coverdell education savings account as defined in section 530 of the Code, or other similar account.

[6] 75 Fed. Reg. at 47078, n.184.

[7] Deloitte Consulting LLP, International Foundation of Employee Benefit Plans, and the International Society of Certified Employee Benefits Specialists (ISCEBS), 401(k) Benchmarking Survey 6 (2009).

- Participants who terminate participation in a plan also exit funds held through their plans. One study reports that the median tenure of a 401(k) plan participant was measured to be 8.7 years by the Vanguard Group, and 7.0 years by EBRI/ICI.[8]
- An employee who terminates employment is likely to terminate plan participation (and therefore exit the funds held through his or her plan).[9] According to the U.S. Bureau of Labor Statistics, the median number of years that wage and salary workers worked for their current employer was 4.4 years in January 2010.[10]
- A participant also must exit a fund held through a plan when the fund is removed from the plan's investment line-up. One survey reports that 82% of 401(k) plans have replaced a fund due to poor performance within the last 5 years.[11]
- Generally, average shareholder tenure (whether or not shares are held through a plan arrangement) with a mutual fund is 8 years.[12]

Although this data does not rule out that some plan participants could remain invested in the same fund for as long as fifteen years, it suggests that only very few participants are likely to do so. In light of this, it is important that the Commission consider whether the retirement plan industry must make burdensome and costly systems modifications to comply with the limits on ongoing sales charges that would be imposed by proposed Rule 6c-10.

*B. If no safe harbor is adopted, most retirement plan recordkeeping systems must undergo burdensome and costly modifications; plans and participants — particularly in small plans — will ultimately bear these costs.*

To comply with the limits on ongoing sales charges that would be imposed by proposed Rule 6c-10, recordkeeping systems must be converted to initially record and track the "age" of shares, provide for automatic conversion of shares at the appropriate time, and to maintain two share classes of each fund available under a plan. In its proposal of the amended regulations (the "Release"), the Commission recognizes that making these changes and managing the aging of shares and conversions over time will involve substantial initial and ongoing costs to plan providers.[13] The Commission's estimated costs are significant — an approximate $1 million one-time cost for initial conversion of the recordkeeping system and about $1.5 million annually to manage the automatic conversion of sales charges for each plan provider's recordkeeping system, resulting in a one-time cost of $177 million and annual

[8] Takeshi Yamaguchi, University of Michigan Retirement Research Center, Understanding Trading Behavior in 401(k) Plans 25, (2006).
[9] An employee who terminates employment typically may (i) take a lump sum distribution of his or her account balance from the plan, (ii) "rollover" the account balance to an individual retirement account (IRA) or to a tax-qualified plan maintained by a new employer, or (iii) leave the account balance in the plan sponsored by his or her former employer. Data from approximately 3.7 million plan participants showed that 66 percent of participants cashed out or rolled their assets to an IRA when they terminated employment or retired in 2008. *See* The Principal, Retirement Plan Trends Report: The Total View, p. 15 (2009). Approximately 16.2 million workers reported receiving a lump-sum distribution from a retirement plan (in cash or for rollover to an IRA) when changing jobs as of April of 2006. *See* Employee Benefits Research Institute, Lump-Sum Distributions at Job Change, EBRI Notes, p. 1 (2009).
[10] Bureau of Labor Statistics, U.S. Department of Labor, Employee Tenure in 2010, p. 1 (2010).
[11] 2009 Deloitte/IFEBS Benchmarking Survey, *supra* n. 10, at 6.
[12] Investment Company Institute, 2010 Investment Company Fact Book 87, 50th ed., p. 87 (2010).
[13] 75 Fed. Reg. 47120.

costs of $265 million[14] — ASPPA believes that these costs may be significantly understated based on information provided by its members.

First, the Commission must recognize the complexity of recordkeeping systems maintained by the retirement plan services industry as compared to brokerage recordkeeping systems that may currently track share lot history or might be easily converted to do so. Recordkeeping systems for 401(k) and similar participant directed plans are required to support, within each participant's account record, separate "buckets" for different types of amounts contributed under a tax-qualified plan, including employee pre-tax payroll contributions (and post-tax contributions if allowed), employee rollovers, and employer matching contributions (which may be both non-vested and vested). These systems also must support considerable volumes of participant-level transactions, including the periodic investment of new contributions (typically, bi-weekly), participant-directed exchanges among the funds available as plan investment alternatives, reinvestment of dividends and distributions, and loans and other distributions. Modifying these systems to track share lot history for each transaction and manage the conversion of shares on an ongoing basis (including the costs of maintaining at least two share classes for each fund investment option under a plan) is likely to be far more expensive than the Commission has estimated. In this regard, preliminary estimates from one ASPPA member are that initial recordkeeping system modifications (for only one of its recordkeeping platforms) could be at least $1.5 million; another ASPPA member's preliminary estimate is that initial modifications would be at least $2 million and could be significantly more.

Second, the estimate described by the Release assumes that only one-third of recordkeepers that currently provide services to plans investing in share classes with 12b-1 fees of more than 25 basis points will modify their recordkeeping systems.[15] ASPPA believes that competitive pressure will require most (if not all) recordkeepers to modify their systems. For example, all of the CIKR members that were polled have indicated that they would modify their recordkeeping systems. Therefore, the estimated costs must be revised to reflect that some 500 plan providers are likely to be obligated to modify their recordkeeping systems, instead of the 177 estimated in the Release.

Importantly, the costs are more likely to be borne by plan administrators and recordkeepers providing services to small plans and the participants in these plans, because small plans are more likely to be invested in funds with 12b-1 fees exceeding 25 basis points. Further, ASPPA believes that these initial and ongoing costs are likely to cause some plan providers (*e.g.*, recordkeepers and administrators) to exit the retirement plan administration business, which can be expected to reduce competition and the overall efficiency of the market. Accordingly, plans and participants (especially in small plans) can expect to pay higher fees because there will be less competition among plan recordkeepers and administrators, and the remaining recordkeepers and administrators will expect to recoup their transition and ongoing costs for complying with limits on ongoing sales charges by imposing higher fees.

[14] 75 Fed. Reg. 47121.
[15] 75 Fed. Reg. 47121.

### *C. Plans and participants may be harmed even if recordkeepers do not modify their systems to accommodate automatic conversions.*

The Release suggests that, as an alternative to modifying their systems, some recordkeepers may restrict access to their platforms to mutual fund share classes without ongoing sales charges that exceed the 25 basis point marketing and service fee permitted by proposed Rule 12b-2. However, limits on the availability of ongoing sales charges in excess of 25 basis points from the retirement plan services market may have unintended and unfavorable effects on plans and participants, especially in the small plan market.

First, these fees pay for important services that facilitate establishment of new plans by small businesses. Especially in the small and micro plan markets, ongoing 12b-1 fees compensate brokers and advisers (in addition to compensating for recordkeeping services) for specialized marketing services, which may include explaining to employers the requirements for establishing a retirement plan, the advantages (to the employer as well as employees) of establishing and continuing a plan, assisting the employer with the selection of investments and service providers to the plan, and helping with the enrollment process. These fees also support the delivery of necessary ongoing services to plans and participants, including consulting on fund selection and monitoring, participant education about plan features and investment options, and providing communications to participants required by the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), such as blackout notices, information needed to comply with ERISA section 404(c), and other required participant disclosure, including prospectuses, annual reports, and fund fact sheets. The availability of these initial and ongoing services often is essential to an employer's decision to offer a plan to employees and its willingness to continue the plan. However, if brokers who are plan providers cannot be compensated by ongoing sales charges (in excess of a 25 basis point marketing and service fee permitted by proposed rule 12b-2), they may focus on larger plans with more assets and limit the services they offer to small and micro plans. The result may be that fewer employers, particularly in the small and micro plan markets, will establish and continue plans, and fewer employees will be provided an opportunity to save for retirement under a more advantageous tax-qualified plan.

Second, if they cannot be appropriately compensated for providing these services to plans when they market mutual funds to plans, brokers who are plan providers may leave the market, or may favor other, non-mutual fund products (*e.g.*, collective trust funds and insurance contract products) that are not subject to similar limits on fees paid for sales and distribution through expense ratios. In this regard, ASPPA urges the Commission to consider the entire universe of investment products available in the retirement services market and whether the proposed rule amendments may disproportionately disadvantage some investment products while advancing others. Particularly with smaller plans, brokers who initially sell the plan and the mutual funds that will be provided as investment alternatives under that plan — and then receive 12b-1 fees for the sale — often provide the important follow-on services described above (*e.g.,* fund monitoring, participant education and communication services) without further compensation (other than the 12b-1 fees). In comparison, investment advisers may be paid for these follow-on services based on assets under management, or if a plan invests through an insurance product rather than in mutual funds, insurance sellers receive complex and lucrative trail commissions. If the sales compensation that brokers selling mutual funds may receive, and the length of time over which they can receive that compensation, are capped as proposed, these brokers will have less economic incentive to sell mutual funds to plans and they may cease to participate in this market, leaving a vacuum to be filled by insurance or other non-mutual fund products. The result would be fewer investment product choices for plan investors to choose from and less competition to keep costs competitive.

ASPPA understands the Commission's desire to do away with problematic and excessive broker compensation arrangements that have evolved under the current Rule 12b-1, but changes to address that issue should not undermine the success of servicing and administration arrangements that the current Rule 12b-1 has fostered for participant-directed retirement plans. Therefore, we urge that the Commission not throw out the retirement plan servicing "baby" with the broker compensation "bathwater." Adopting the proposed safe harbor is important to ensure the continuation of services that are important to the establishment and continuation of plans, and to maintain mutual funds as competitive with insurance and other investment products available to retirement plans.

D. *Recent Labor Department regulation of plan fee arrangements requires enhanced disclosure to employers responsible for selecting plan service providers and investments, including mutual funds.*

As the Commission is aware, the Labor Department has adopted and is implementing new reporting and disclosure regulations designed to improve the disclosure to employers and plan sponsors about fees paid directly and indirectly by plans for retirement services, including fees paid from mutual funds.[16] In addition, the Labor Department recently issued new regulations requiring disclosures to participants in participant-directed plans, including disclosure of total investment expenses and any sales charges.[17] These regulations are designed to protect plans and participants by ensuring that the fiduciaries of plans responsible for selecting a plan's fee and services arrangements receive sufficient information to make informed decisions and participants are aware of the total costs they pay for plan administration and investment services. As a result, plan investors (including employers and other plan sponsors) and participants will be aware of any fees being paid, such as an ongoing sales charge under the safe harbor. Thus, the Commission should be confident that plan investors will receive sufficient information to make informed investment decisions about plan fees and expenses, including ongoing sales charges, if a safe harbor rule applicable to plan investors is adopted.

[16] DOL has adopted new requirements for reporting the direct and indirect compensation that plans pay for services, including fees paid indirectly by plans as a result of investments in mutual funds and other investment products. See 2009 Schedule C Form and Instructions, 72 Fed. Reg. 64710 and 64731 (Nov. 16, 2007). More recently, DOL issued an interim final regulation requiring retirement plan service providers to disclose their direct and indirect compensation for plan services. 75 Fed. Reg. 41600 (July 16, 2010).
[17] 75 Fed. Reg. 64910 (Oct. 20, 2010).

## II. Permit Transition of Plan Investors to "Safe Harbor" Shares

The proposed rule amendments include provisions that are intended to facilitate the transition to the proposed new framework for regulating the use of fund assets to pay distribution costs, including a "compliance period" during which funds would make necessary changes to comply and a "grandfathering period."[18] Shares sold after the end of the compliance period would be required to comply with the new rules, and shares sold before the end of the compliance period would be required to be converted or exchanged to a share class with no ongoing sales charge at the end of the grandfathering period.

ASPPA urges the Commission to modify these transition provisions to accommodate funds that offer the proposed safe harbor shares to plan investors (as described above) so that (1) plan investors need not be converted to a share class with no ongoing sales charge at the end of the grandfathering period, so long as they are invested in a class of shares that satisfies the safe harbor (as described above), and (2) at the end of the grandfathering period, plan investors in share classes with ongoing sales charges exceeding amounts permitted by the plan investor safe harbor may be converted to a share class that satisfies the proposed safe harbor, rather than requiring conversion to a class with no ongoing sales charge.

These modifications are important because, first, they would allow plan providers to avoid the substantial expenses they would otherwise incur in connection with required conversions at the end of the proposed grandfathering period. Since providers are likely to pass these costs on to plans and plan participants, plans and plan participants also would benefit. Further, these modifications will permit "R" share classes of funds that have been structured to compensate for plan services through an ongoing asset-based distribution fee to be transitioned to a share class that will still provide an ongoing sales charge, thereby minimizing the disruption to those plans that receive necessary plan services by investing in R shares.[19] In this regard, ASPPA believes that it will be unnecessarily disruptive to require employer plan sponsors to renegotiate their plan's services agreements where they had selected R shares in order to pay certain costs that otherwise would be charged directly to the plan.

Moreover, without transition rules that will allow an orderly transition of plan investors to a share class with ongoing sales charge that may be used to pay for plan services, some brokers may, before the compliance period terminates, "churn" plan investments by encouraging employers to change their plans' investment menus to funds with higher ongoing sales charges that will apply until the end of the grandfathering period. This activity will increase plan costs directly, as plans may be converted to share classes that pay higher fees. Plans would also incur additional indirect costs, because a higher volume of changes in plan fund menus will increase plan provider costs and these costs are likely to be passed through to plans.[20] However, ASPPA believes this type of activity may be minimized by the availability

[18] 75 Fed. Reg. 47101.

[19] The Release recognizes the potential for disruption where plans currently investing in R shares are required to convert to other share classes. 75 Fed. Reg. 47101.

[20] We anticipate these costs to be significant due to the significant amount of work involved in changing funds. The process for changing a fund typically includes adding the replacement fund to the recordkeeping system,

of a safe harbor class for plan investors and transition rules that will permit funds to charge a limited ongoing sales charge, and not require conversion.

### III. Extend Proposed Compliance Period, if There is No Plan Investor Safe Harbor

The Release contemplates that the "compliance period" described above would end 20 months after adoption of the rule proposals. However, ASPPA believes that this period will be too short to allow plan recordkeepers and administrators sufficient time to make changes to their recordkeeping systems and procedures to comply with the limits on ongoing sales charges that would be imposed by proposed Rule 6c-10. It is important to recognize that plan recordkeepers and administrators will be required to respond to the changes that funds and fund managers will be required to make to their funds' operating systems, distribution agreements and other agreements, and registration statements (including the related disclosures). Plan recordkeepers and administrators will not be able to complete (if they can even begin) their own changes to operating systems and procedures, and necessary communications to plan investors and participants in those plans, until funds and fund managers are able communicate their new requirements with certainty. Moreover, as discussed above, recordkeeping systems maintained by the retirement plan services industry are extremely complex and will not be easily converted to track the "age" of shares, provide for automatic conversion of shares at the appropriate time, and to maintain two share classes for each fund available under a plan.

Therefore, if the Commission does not provide the proposed safe harbor for ongoing sales charges applicable to plan investors, ASPPA urges the Commission to extend the "compliance period" for making changes to comply with the proposed rules to at least 36 months after the date that amended rules are adopted.

### IV. Preserve Funds' Flexibility to Pay for Plan Administration and Compliance

To minimize unnecessary disruption in retirement plan services, it will be important that a regulatory framework that replaces Rule 12b-1 preserves funds' flexibility to pay for services to plan investors, including for plan administration, and other plan compliance services, for receiving, consolidating and transmitting participant and plan orders for purchases and redemptions of mutual fund shares through trading platforms ("trading services") and for distribution services. ASPPA urges the Commission to ensure this flexibility in two ways.

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coding the replacement fund with all of the required parameters, sending advanced mailings to all plan participants, updating enrollment materials, updating qualified default investment alternative (QDIA) notices if applicable, updating the ERISA section 404(c) fulfillment system, notifying fund companies about large planned redemptions, liquidating the prior fund, reinvesting the proceeds in the replacement fund, and updating the voicing codes in the voice response unit (VRU). One recordkeeper estimates that the costs associated with these services will average $200 per fund plus $2 per participant. The costs for the 2,000 plans and 200,000 participants that it services (based on an estimated amount of 18 funds per plan) are projected to be $7.6 million. (That is, 2,000 plans x 18 funds per plan x $200 per fund = $7.2 million; plus 200,000 participants x $2 per participant = $0.4 million.)

First, the Commission should not prohibit funds from paying for a mix of distribution and non-distribution services from a service and marketing established under Rule 12b-2. In this regard, the Release recognizes that fees paid under a Rule 12b-1 plan currently may pay for a mix of distribution and administrative (non-distribution) services and that proposed Rule 12b-2 also would not preclude funds from paying for such "mixed expenses"[21] ASPPA urges the Commission to maintain this position with respect to proposed Rule 12b-2, to provide funds with flexibility and so that existing arrangements for delivering services to plan investors need not be restructured. For example, numerous financial intermediaries currently engage plan providers (such as banks and trust companies as well as recordkeepers and administrators)[22] to provide plan administration and other plan compliance services, and trading services for plan accounts that are held on the fund's books and records in the name of the financial intermediaries, and these plan providers may also collect 12b-1 fees, shareholder servicing fees and sub-administration fees associated with the plan accounts for providing these services. In most cases, these fees are used to offset or reduce administration and other plan compliance costs and the cost of trading services that plans would otherwise pay.

In addition, the Commission should confirm that fees paid from funds for plan recordkeeping, administration, plan compliance activities and trading services provided to plans will not be deemed to finance "distribution activity" as defined by proposed Rule 12b-2. In this regard, proposed Rule 12b-2 would limit mutual funds' payments for "distribution activity" to amounts that are allowed as a marketing and service fee under proposed Rule 12b-2 and ongoing sales charges under the proposed amendments to Rule 6c-10. Although these limits may disrupt standard practices providing for payment of certain plan-related expenses from fund assets through 12b-1 plans or other arrangements, including expenses for, *e.g.*, recordkeeping and administration (producing account statements, recording transactions), maintaining call centers and internet websites for use by participants, and providing participant education,[23] the Release suggests that this impact may be mitigated because some mutual funds with higher 12b-1 fees could "reclassify" a portion of the expenses currently paid under their 12b-1 plans as "operating expenses" that are not subject to the proposed Rule 12b-2/6c-10 limits on amounts paid from funds for distribution activity. Therefore, the Commission appears to expect that funds will be able to continue payments that support plan recordkeeping and other services, with minimal disruption.[24]

ASPPA remains concerned, however, that funds may not be able to continue payments that support plan recordkeeping and other services necessary to a plan's operation and continued ability to invest in mutual funds. In this regard (and as recognized by the Commission), legal standards for determining what expenses finance "distribution activity" are not clear. For example, many funds have adopted "defensive" 12b-1 plans that currently characterize non-distribution expenses — including amounts paid to support plan recordkeeping and other plan compliance services — as potentially distribution-related.

[21] 75 Fed. Reg. at 47075, n.153.
[22] The Commission has previously acknowledged the existence of such intermediaries in its rulemaking, see, *e.g.*, Rule 22c-2(c)(1)(iii), which recognizes that persons other than a financial intermediary may maintain the participant records of participant-directed employee benefit plans.
[23] 75 Fed. Reg. 47071.
[24] 75 Fed. Reg. 47114.

The language in the Release highlights the lack of clarity in this area. It describes various services provided to plan investors and states that "[d]ifferent funds take different approaches to paying these expenses. Some funds may specifically identify operational costs and pay them outside of rule 12b–1. Other funds might, for convenience, use 12b–1 fees to pay all of these expenses to avoid the need to determine exactly which of the expenses contribute to fund distribution."[25] The Release does not resolve this issue, but instead appears to suggest that the current process will continue. It states "According to the Investment Company Institute, retirement plan assets are typically invested in low cost funds. Approximately 80 percent of 401(k) plan assets are held in mutual fund share classes that pay no 12b–1 fees or 12b–1 fees of 25 basis points or less. If our proposals are adopted, we would therefore expect that funds could continue to make the payments from the proceeds of the marketing and service fee."[26]

Without additional guidance, funds may still take conservative positions, so that the "recharacterization" of expenditures will not occur as anticipated. Therefore, ASPPA urges the Commission to confirm that mutual fund expenditures for "plan compliance" will not be deemed to be paid to finance a "distribution activity" as defined by proposed Rule 12b-2 purposes. Specifically, the following services typically provided by plan administrators and recordkeepers should be permitted to be paid from fund operating expenses in the form of a sub-transfer agency, or other "administrative" type fee:

- recordkeeping of participant accounts maintained in connection with participant-directed retirement and similar plans;
- receiving, consolidating and transmitting participant and plan orders for purchases and redemptions of mutual fund shares through trading platforms;
- preparing and distributing required communications to fiduciaries and participants of plans (including plan descriptions, periodic benefit statements and other legally required notices and information);
- plan compliance services (including required tax-qualified plan testing, plan audits and annual reporting);
- responding to participant inquiries regarding their fund investments and plan recordkeeping and administration, to fund inquiries relating to plan investors, and to regulatory inquiries regarding fund and plan information; and
- providing fiduciary compliance services, by acting as, or assisting, a plan fiduciary (*e.g.*, the plan sponsor) in complying with its legal responsibilities as a plan fiduciary.

These activities generally are similar to, and/or overlap with, administrative and ministerial services that are not treated as involving "sales" or "distribution-related" activities under applicable FINRA guidance.[27] Also, these activities do not appear to be "distribution

[25] 75 Fed. Reg. 47100 (footnotes omitted).
[26] 75 Fed. Reg. 47100 (footnotes omitted).
[27] NASD Notice to Members 93-12 (1993), at Section III, Question #17, discusses the definition of "service fees" and explains that service fees do not include amounts paid for transfer agent, custodian or similar services or charges for maintenance of records, recordkeeping, including any of the following: (i) transfer agent and subtransfer agent services for beneficial owners of fund shares, (ii) aggregating and processing purchase and

activities" as defined by proposed Rule 12b-2 because they are provided to existing rather than to prospective shareholders. In this regard, proposed Rule 12b-2 would define "distribution activity" as "any activity which is primarily intended to result in the sale of shares ... including, but not necessarily limited to, advertising, compensation of underwriters, dealers and sales personnel, the printing and mailing of prospectuses to other than current shareholders, and the printing and mailing of sales literature."[28]

Therefore, if the Commission seeks to avoid significant adverse impact on plan service providers, plans and plan participants, the Commission should confirm that fees paid from mutual funds for administrative and other "plan compliance" services will not be deemed to finance "distribution activity" under proposed Rule 12b-2. Without these confirmations, existing industry arrangements for paying plan expenses from fund assets would be threatened by uncertainty about what types of ministerial, administrative and shareholder service activities may be characterized as "operating expenses" of a fund. At the same time, it is important that this clarification also does not disrupt current practice by precluding the use of fees paid under proposed Rule 12b-2 for a mix of distribution and administrative (non-distribution) services.

## V. Discussion of Whether to Address How Plan Investors Use 12b-1 Fees Must Consider Costs of Regulation and be Coordinated with the Labor Department

In connection with its discussion about the use of fund assets to pay for plan administrative and compliance services, the Release requests comment on whether payments to plan service providers from the proceeds of 12b-1 fees currently may "pay for services that may not be exclusively attributable to the funds in which those assets are invested ..." and if so, "are fund assets potentially being used to pay for services to non-fund investors (*i.e.*, not for the exclusive benefit of fund investors)?"[29] In considering this issue, the Commission must consider the likely costs of rules that would require funds to inquire about the use of fees paid for marketing, shareholder services, administration and other services provided to plan investors, and coordinate any rulemaking on this matter with the Labor Department.

ASPPA believes that it would be complex and burdensome to administer rules designed to ensure that payments from mutual funds for plan administration and compliance services are used solely for the benefit of those participants who beneficially hold a fund's shares. First, it is not feasible to distinguish plan compliance and administration services between (i) those services that exclusively benefit a participant investing in a particular fund, and (ii) services necessary to support the operation and administration of a plan in general. Both are required to maintain a plan such that participants continue to have the opportunity to invest in and remain invested in a mutual fund investment option offered under the plan.

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redemption orders, (iii) providing beneficial owners with statements showing their position in the investment company, (iv) processing dividend payments, (v) providing subaccounting services for fund shares held beneficially, (vi) forwarding shareholder communications, such as proxies, shareholder reports, dividend and tax notices, and updating prospectuses to beneficial owners, or (vii) receiving, tabulating and transmitting proxies executed by beneficial owners.

[28] 75 Fed. Reg. 47076.

[29] 75 Fed. Reg. 47100.

Further, requiring mutual funds to establish policies and procedures to address how fees paid for plan services will be used (and whether any amounts might "subsidize" services that benefit participants who do not invest in the fund) may be burdensome because funds would be required to seek information from plan providers about their practices, which could discourage funds from providing fund assets to pay for plan compliance and administration. Also, requiring plan service providers to respond to fund inquiries about whether amounts paid by a fund are used solely for the benefit of plan participants investing in a particular fund would impose additional expenses on plans and plan participants.

Moreover, where a participant-directed plan offers a selection of funds, and not all shares offer the same level of 12b-1 fees to pay for plan administration and compliance, there are potential issues regarding whether there is a reasonable allocation of plan expenses among plan participants under ERISA's fiduciary responsibility provisions. The Labor Department has issued guidance addressing the allocation of fees and expenses among participants in participant-directed plans.[30] This guidance provides that, as an initial matter, employee benefit plans must be operated in accordance with the terms of governing plan documents, including any plan provisions that may specify how the plan's expenses should be allocated among participants. It further requires that, to the extent governing documents are silent, the methods for allocating expenses among participants are reasonable. ASPPA is concerned that rules issued under the Investment Company Act for purposes of addressing whether payments from mutual funds for plan administration and compliance services are used solely for the benefit of those participants who beneficially hold a fund's shares (or policies and procedures adopted by funds pursuant to such rules) could potentially conflict with Labor Department guidance or, possibly, the operational requirements of plans' governing documents. Accordingly, it is essential that the Commission coordinate with the Labor Department to avoid regulatory inconsistencies before engaging in rulemaking on this matter.

## VI. Rule Changes Permitting Account-Level Sales Charges Need Additional Evaluation

Proposed Rule 6c-10(c) would allow funds to offer shares at a price that differs from the public offering price stated in the prospectus. ASPPA members have expressed a wide range of divergent views on the issues raised by the proposed rule. Members are concerned that proposed Rule 6c-10(c) (and the section 22(d) exemption for broker-dealers) would permit a fund in certain circumstances to offer its shares or class of its shares at a price other than the current public offering stated in the prospectus. A fund class could offer shares to dealers who would then be free to establish and collect their own commissions or other types of sales charges to pay for distribution. The amount of these fees and the times at which they would be collected would not be governed by the Investment Company Act. In the retirement industry, mutual fund shares are purchased in a number of ways, such as through a retirement plan broker-dealer platform, directly from the fund company, or through an automated National Securities Clearing Corporation (NSCC) clearing with a trust company, broker-dealer, or third party (TPA recordkeeper) who has a NSCC membership. Under all of these arrangements, the 401(k) recordkeeper is providing the participant account level recordkeeping and the NSCC member broker-dealer is simply holding an omnibus position by plan or master account level.

[30] *See* Field Assistance Bulletin (FAB) 2003-03 (May 19, 2003).

Consequently, unlike a retail account at a retail broker-dealer, the need to allow the broker-dealer (and a section 22(d) exemption) to account for the level fee at the participant level does not exist. Today, most of our members are able to access the purchase of a mutual fund on a competitive basis by choosing independently the broker-dealer, trust company, bank, NSCC member firm, or a direct relationship with the fund company. Many of our members viewed the section 22(d) exemption as possibly interfering with this currently competitive marketplace. Ultimately, before the Commission considers this further, we would strongly suggest significant further study on the potential marketplace effects.

However, ASPPA members agree that the SEC should consider allowing existing share classes to be more easily changed as soon as possible. Such a change would enable fund companies to provide additional options to a greater spectrum of investors without having to change out all of the fund share classes, resulting in less disruption and confusion.

Thank you for your consideration. We look forward to continuing our discussions with the Commission and staff of the Division of Investment Management about these issues. If you have any questions regarding the matters discussed herein, please contact Brian Graff at (703) 516-9300.

Sincerely,

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