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November 4, 2010

Via Email

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

Re: File No. S7-15-10
Mutual Fund Distribution Fees; Confirmations -- Rel. No. IC-29367 (July 21, 2010)

Dear Ms. Murphy:

We respectfully submit this comment letter in regard to the above-referenced release (the "Proposing Release").¹ Dykema Gossett PLLC represents a number of funds, including both retail funds and funds that serve as underlying investment media for variable insurance products. We also represent fund investment advisers and distributors and their affiliates.

This letter addresses one issue: the treatment under the Proposal of "service fees" as defined in NASD Conduct Rule 2830 ("Service Fees").

In the Proposing Release, the Commission states its goals of having the Proposal "largely preserve existing distribution arrangements," provide fund managers and directors "with greater legal certainty regarding many distribution financing practices that have developed over the years" and "eliminate uncertainties associated with current requirements."² We believe that the

¹ In the Proposing Release, the Securities and Exchange Commission (the "Commission") proposes, among other things, to: rescind current Rule 12b-1 under the Investment Company Act of 1940, as amended (the "Act"), which permits an open-end registered investment company (a "fund") to pay for the distribution of its shares with fund assets; adopt new Rule 12b-2 under the Act, which would permit a fund to assess for the life of the fund an annual "marketing and service fee" of up to 0.25% that is to be used "to finance distribution activities"; and amend Rule 6c-10 under the Act to permit a fund to assess an "ongoing sales charge" that would be subject to a cumulative expense cap (the "Proposal").

² Proposing Release at 126 and 8.

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discussion of Service Fees in the Proposing Release falls short of these goals and request that the Commission, in proceeding with the Proposal, clarify that a fund would be entitled to pay a Service Fee outside of Rule 12b-2 to the same extent that such a fee may currently be paid outside of Rule 12b-1. This clarification would, by reiterating the Commission's historical view of the status of Service Fees under Rule 12b-1, eliminate uncertainties that the Proposal raises.

Background

NASD Conduct Rule 2830. NASD Conduct Rule 2830 defines the term "Service Fees" to mean payments for "personal service and/or the maintenance of shareholder accounts."³ Service Fees are intended "to compensate members for shareholder liaison services such as responding to customer inquiries and providing information on their investments" ("Shareholder Services").⁴ The Rule provides that Service Fees may not exceed 0.25% annually of fund assets.⁵

NASD Conduct Rule 2830 contemplates that a fund, in addition to paying Service Fees for Shareholder Services, may pay for services that fall into two other general categories: (1) distribution services; and (2) administrative services.

Payments for distribution services are called "sales charges," a term which the Rule defines to mean "all charges or fees that are paid to finance sales or sales promotion expenses, including front-end, deferred and asset-based sales charges."⁶

Payments for administrative services may be called "administrative service fees." NASD Conduct Rule 2830 includes in this category fees for the following kinds of services: transfer agent and sub-transfer agent services; custodian services; accounting and sub-accounting

³ NASD Conduct Rule 2830(b)(9). NASD Conduct Rule 2830 was originally Article III, Section 26 of the Rules of Fair Practice of the National Association of Securities Dealers, Inc. ("NASD"). The Financial Industry Regulatory Authority ("FINRA") has proposed changes to NASD Conduct Rule 2830 and to recodify it as FINRA Rule 2341. FINRA Rule 2341 would define the terms "sales charge" and "service fee" in the same way as they are defined in NASD Conduct Rule 2830 and continue the distinction the NASD originally intended between the two terms. FINRA Regulatory Notice 09-34 (Jun. 2009) at n.7.

⁴ NASD Notice to Members ("NTM") 93-12 (Feb. 1993) at Q. 17. The Proposing Release describes a Service Fee as one that "a fund may deduct annually from fund assets in order to pay intermediaries for providing follow-up information and account services to clients over the course of their investment in the fund." Proposing Release at 21-22, citing NASD Conduct Rule 2830(d)(5).

⁵ NASD Conduct Rule 2830(d)(5).

⁶ NASD Conduct Rule 2830(b)(8).

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services; recordkeeping services; and forwarding shareholder communications to existing shareholders.⁷

The NASD has stated that “there is a clear distinction between asset-based sales charges and service fees”⁸ and that Service Fees are “to be distinguished from other fees.”⁹ In other words, a Service Fee is not a sales charge or an administrative service fee.¹⁰

NASD Conduct Rule 2830 is thus based on three kinds of fees: Service Fees, sales charges and administrative services fees, each of which addresses a distinct service – Shareholder Services, distribution services and administrative services.

Rule 12b-1. Rule 12b-1 provides that a fund may use its assets to pay for the distribution of its shares. Rule 12b-1 defines “distribution” as:

any activity that is primarily intended to result in the sale of shares issued by the fund, 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.

For purposes of Rule 12b-1, fund fees are viewed as being paid for two kinds of services – distribution services and non-distribution services. Fees for distribution services must be paid pursuant to a written plan that complies with the rule (a “Rule 12b-1 Plan”). Fees for non-distribution services do not have to be paid pursuant to a Rule 12b-1 Plan. Funds, however, may choose to pay fees for non-distribution services pursuant to such a plan.¹¹ If a particular fund intermediary is providing both distribution and non-distribution services, the fund must pay for the distribution services pursuant to its Rule 12b-1 Plan and may pay for the non-distribution services either pursuant to the plan or outside of it.¹²

⁷ NTM 93-12 at Q. 17.

⁸ NTM 93-12 at Q. 23.

⁹ NTM 93-12 at Q. 17.

¹⁰ NASD Conduct Rule 2830 limits the asset-based fees that a fund may pay for sales charges to a maximum annual rate of 0.75% and for Service Fees, as stated above, to a maximum annual rate of 0.25%. The Rule does not limit the maximum annual rate for administrative service fees.

¹¹ “Payment of Asset-Based Sales Loads by Registered Open-End Management Investment Companies,” Investment Company Act Release No. 16431 (Jun. 13, 1988) (“IC-16431”) at n.126.

¹² Id.

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Proposed Rule 12b-2 and Amended Rule 6c-10. Proposed Rule 12b-2 and Amended Rule 6c-10 would provide for two kinds of asset based fees that a fund may use “to finance distribution activity”¹³: a “marketing and service fee” and an “ongoing sales charge.” The Proposing Release indicates that the marketing and service fee may be used, in the same way as Rule 12b-1 fees may be used, to pay for non-distribution services as well as distribution services but that the ongoing sales charge may be used only to pay for distribution services. The maximum amount of the marketing and service fee could not exceed the maximum amount permitted under NASD Conduct Rule 2830 for a Service Fee, currently, an annual rate of 0.25% of fund net assets. An ongoing sales charge would not be subject to a maximum annual rate but would be subject to a cumulative cap determined by reference to aggregate sales charge limits under NASD Conduct Rule 2830.¹⁴

The Historical Treatment of Service Fees

The NASD. The term Service Fee was introduced to the predecessor of NASD Conduct Rule 2830 as a result of an NASD rule making proceeding that began in 1990.¹⁵ From the outset, the NASD’s treatment of Service Fees does not indicate that it contemplated that such a fee would be considered a payment for distribution. In proposing use of the term, the NASD stated:

A service fee is defined to include a continuing payment, made by an investment company or its affiliates, to a member for personal service to investors who own shares of the investment company. Thus, *it is not made in connection with a primary distribution* of investment company securities.¹⁶

After the rule amendment containing the term Shareholder Services became effective, the NASD explained:

¹³ The definition of “distribution activity” in proposed Rule 12b-2 is identical to the definition of “distribution” in Rule 12b-1, i.e., it refers to “any activity that is primarily intended to result in the sale of shares issued by the fund.”

¹⁴ Once the cumulative cap is attained with respect to a share, that share must convert to a share class having no ongoing sales charge.

¹⁵ See: NTM 90-26 (Apr. 1990); NTM 90-56 (Apr. 1990); NTM 92-41 (Aug. 1992); NTM 93-12; “Notice of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to the Limitation of Asset-Based Sales Charges as Imposed by Investment Companies,” Exchange Act Release No. 34-29070 (Apr. 12, 1991) (“34-29070”); and “Order Approving Proposed Rule Change Relating to the Limitation of Asset-Based Sales Charges as Imposed by Investment Companies,” Exchange Act Release No. 30897 (Jul. 7, 1992).

¹⁶ NTM 90-26 at 3 (emphasis added).

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[S]ervice fees are intended to be distinguished from other fees as a payment for personal service provided to the customer. [They are] essentially intended to compensate members for shareholder liaison services they provide, such as, responding to customer inquiries and providing information on their investments.¹⁷

In further explaining the term after its adoption, the NASD stated that there is “a clear distinction between asset-based sales charges and service fees” and “if an item is a service fee, [it] is outside the scope of [NASD Conduct Rule 2830’s] limits on sales charges.”¹⁸ In other words, a Service Fee is paid for services that are different from services for which it would be appropriate to pay a sales charge or an administrative services fee.

The Commission. In proposing approval of the changes that became NASD Conduct Rule 2830, the Commission expressly recognized the “distinction between ‘sales charges’ and ‘service fees’” that the NASD intended.¹⁹

The Commission has recognized in other contexts the appropriateness of the payment of Service Fees outside of Rule 12b-1. For example, Registration Statement Form N-1A under the Act provides for different treatments of payments of Service Fees in a fund’s expense table depending on whether the payment is made pursuant to Rule 12b-1 or outside of Rule 12b-1.²⁰

In adopting Rule 18f-3 under the Act dealing with multi-class funds, the Commission distinguished between shareholder services and distribution services in requiring that each class “have a different arrangement for shareholder services or the distribution of securities or both.”²¹ In proposing Rule 18f-3 in 1993, the Commission described the distinction between shareholder services and distribution services as follows:

Shareholder services may include establishing and maintaining customer accounts and records, providing periodic account statements, arranging for bank wires, processing dividend payments, forwarding fund communications (such as proxies,

¹⁷ NTM 93-12 at Q. 17 (citing NTM 92-41 (Aug. 1992)).

¹⁸ Id. at Qs. 24 and 25.

¹⁹ 34-29070 at 6.

²⁰ Form N-1A, Item 3 at Instruction 3(b) and Item 12. See *Investment Company Filing Guidance – 1994* (Feb. 25, 1994) (“Service fees not deducted pursuant to a Rule 12b-1 Plan should be included under ‘Other Expenses’ and, as provided in the instructions to the fee table, may be shown separately”).

²¹ Rule 18f-3(a)(1)(i).

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shareholder reports and dividend, distribution, and tax notices), answering routine customer inquiries, and assisting with changes in dividend options. Distribution services may include advertising and marketing, sales support services, and preparing, printing, and mailing sales literature, prospectuses, and other reports to prospective investors.²²

The Commission, referring to NTM 93-12, continued on to note: “The scope of ‘shareholder services’ in this context may differ from that of the term ‘service fee’ in [NASD Conduct Rule 2830]. That term is not intended to include transfer agent, custodian, or similar fees or charges for the maintenance of records, recordkeeping, and related costs.”²³ In other words, the term “shareholder services” as used in Rule 18f-3 covers the kinds of services referred to in this letter as Shareholder Services and as administrative services. In proposing Rule 18f-3, the Commission also stated that a board of directors could decide to adopt a “shareholder services plan . . . that was not subject to rule 12b-1.”²⁴

In addressing situations in which a fund entered into arrangements with banks or other financial institutions, the Commission described the relationship between payments for shareholder services and Rule 12b-1 Plans as follows:

In many cases, the fund also makes payments to the institution for providing “administrative services” or “shareholder services.” Some funds have paid for such services through a 12b-1 plan, apparently to address the possibility that the payments may later be characterized as distribution expenditures. Whether particular shareholder or other services are “primarily intended to result in the sale of fund shares” and, therefore, must be paid under a 12b-1 plan, will depend on the surrounding circumstances. However, to the extent a fund is paying for legitimate non-distribution services, such payments need not be made under a 12b-1 plan, even if the recipient of the payments is also involved in the distribution of fund shares.²⁵

The Staff of the Commission has also expressly recognized the permissibility of funds’ paying Service Fees outside of their Rule 12b-1 Plans. In addressing fund supermarkets, the Staff has taken the position that funds may pay for the non-distribution services provided by

²² Investment Company Act Rel. No. 19955 (Dec. 15, 1993) at 9.

²³ *Id.*

²⁴ *Id.* at 7.

²⁵ IC-16431 at n.126. The Commission added that “whether or not payments are for distribution is a question of fact to be decided by the fund’s board of directors.” *Id.* at n.129.

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those supermarkets by using fees outside their Rule 12b-1 Plans, even though the funds' purpose in participating in the supermarkets was "to sell more of their shares."²⁶

Funds. A number of funds have relied on the distinction between sales charges and Service Fees recognized by the NASD and the Commission and its Staff to pay Service Fees outside of Rule 12b-1. Many of these funds offer retirement class shares in the retirement plan market. The Proposing Release acknowledges that funds that offer shares to retirement plans may pay substantial non-distribution fees to plan administrators to offset the costs of servicing shareholders investing through those plans.²⁷

A number of funds use the fees authorized by their Rule 12b-1 Plans to pay Service Fees. The Proposing Release notes that "more than half of all 12b-1 fees paid by funds are used for this purpose."²⁸ Several years ago the Commission observed that funds were following this practice "apparently to address the possibility that the payments may later be characterized as distribution expenditures."²⁹ The practice thus may reflect uncertainty about whether Service Fees might be deemed an indirect financing of "distribution" and thus unlawful if not included within a Rule 12b-1 fee. It may also reflect a practical efficiency in fund governance because it may make it unnecessary for fund directors to consider whether a particular service constitutes Shareholder Services or whether the fee paid for the service is properly categorized as a distribution/sales charge or a non-distribution/Shareholder Services fee.

In other words, many funds may pay Service Fees pursuant to Rule 12b-1 Plans not because a legal and factual analysis has caused them to conclude that they should, or even because of uncertainty about whether the payments might be deemed for distribution, but simply because they can and find it easier to do it than not.³⁰

²⁶ "Funds . . . are not required to pay for non-distribution services pursuant to rule 12b-1 plans even if the recipient of the payment also is involved in the distribution of fund shares." *Investment Company Institute* (Letter to Craig S. Tyle) (pub. avail. Oct. 30, 1998), citing IC-16431 at n.126.

²⁷ These non-distribution services include advising employers in selecting the investment options offered to employees, performing recordkeeping and administrative functions (e.g., producing account statements and recording transactions), providing educational materials and seminars, and maintaining call centers and Internet Web sites for use by plan participants. Proposing Release at 28 and n.104.

²⁸ Proposing Release at 26 (citing *Investment Company Institute*, 2010 *Investment Company Fact Book* (2010) at 10).

²⁹ IC-16431 at n.126.

³⁰ As explained in an article referenced in the Proposing Release: "Because a fund with a Rule 12b-1 plan is expressly permitted to pay for distribution services, it is not critical to determine whether a particular service it pays for . . . is or is not for distribution." Proposing Release at n.153, quoting Martin B. Byrne, *The Payment of Fund Supermarket Fees By Investment Companies*, 3 *Investment Law*. 2 (1996). The

The Proposal's Treatment of Service Fees

The Proposing Release notes that a “significant use of 12b-1 fees today is for what is typically characterized as ‘services’ provided to investors after the sale by the broker-dealers and other intermediaries who sell the fund” and that, as stated above, “more than half of all 12b-1 fees paid by funds are used for this purpose.”³¹ In a note, the Proposing Release explains:

[W]e understand that funds continue to include “service fees” as distribution expenses under rule 12b-1, *presumably* because the stream of payments (often called “trail commissions”) may act as an inducement to intermediaries’ sales personnel to sell fund shares and, *arguably*, because fund intermediaries would provide these services in the ordinary course of business regardless of whether they receive compensation from the fund (which may be just one of many other investments held by the intermediary’s clients).³²

The proportion of 12b-1 fees paid for Shareholder Services and these assumptions about why funds pay service fees pursuant to Rule 12b-1 Plans appear to have had a large influence on the Commission’s approach to the relationship between Service Fees and the marketing and service fee in proposed Rule 12b-2.³³

The validity of these assumptions is questionable. As discussed above, there does not appear to be any sound basis for concluding that funds pay Service Fees pursuant to Rule 12b-1 Plans only because they believe that the payments are being made, or are concerned that they may be deemed to be made, for distribution. Moreover, the standard for determining whether a payment would be for “distribution” in the case of Rule 12b-1 or for a “distribution activity” in the case of Rule 12b-2 is not whether the payment might be an “inducement” to a sales person to make a sale, as stated in the Proposing Release, but rather whether it is “primarily intended” to result in a sale, as provided by the Rules.³⁴ The observation that intermediaries, “arguably,” are

conclusion stated in the text is also supported by the Commission’s determination that “[a]pproximately 80 percent of fund assets that are subject to 12b-1 fees are charged 12b-1 fees of 25 basis points or less.” Proposing Release at 123.

³¹ Proposing Release at 26.

³² Proposing Release at n.100 (emphasis added).

³³ The assumptions are repeated later in the Proposing Release at n.153 and accompanying text.

³⁴ This reduction in the standard appears to be inconsistent with the position taken historically by both the Commission and the Staff that an intermediary who is “involved in the distribution of fund shares” and who also provides non-distribution services may receive payment for those non-distribution services outside a Rule 12b-1 Plan. IC-16431 at n.126; *Investment Company Institute*, note 26, *supra*. We also note that the attempt to equate “trail commissions” and Service Fees is inconsistent with the historical

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likely to perform services even in the absence of compensation ignores the finding implicit in the NASD's statement in proposing to provide specifically for Service Fees in NASD Conduct Rule 2830 that it wished "to *encourage* members to give continuing service to their customers after the sale."³⁵

These assumptions and the relative amount of 12b-1 fees paid for Shareholder Services appear to have colored the discussion of the relationship between Service Fees and the marketing and service fee in the Proposing Release, which suggests at many points that under the Proposal a Service Fee is to be viewed as a payment for distribution activity. The Proposal starts from the premise that "service fees" are a "constituent" part of Rule 12b-1 fees³⁶ and proceeds to refer to "the continuing shareholder account services encompassed by the NASD service fee" as a "legitimate distribution related activity,"³⁷ to Service Fees as a "type of distribution cost"³⁸ and to the marketing and service fee and the ongoing sales charge collectively as "asset-based distribution fees."³⁹

This treatment of Service Fees as a kind of distribution expense contrasts sharply with previous positions taken by the NASD and the Commission. The NASD in NASD Conduct Rule 2830 clearly differentiated between sales charges that, like Rule 12b-1 fees, are intended to finance distribution, and Service Fees that are intended to finance Shareholder Services. The

development of the terms. In describing its substitution of the term "service fees" for the previously used term "trail commission," the NASD stated that it "believes the term 'service fees' more accurately describes the intent of the payments and intends that the term 'trail commission' not be used in the future to describe such payments." NTM 93-12 at n.6.

³⁵ NTM 90-56 at 1 (emphasis added). The NASD stated: "The [NASD Board of Governors] wishes to encourage members to give continuing service to their customers after the sale and believes that this activity deserves the reasonable continuing compensation provided for in the proposed amendments."

³⁶ The Proposing Release states that the Proposal "would, like NASD Conduct Rule 2830, differentiate between the two constituent parts of current 12b-1 fees (asset-based sales charges and service fees)." Proposing Release at 38. The Proposing Release repeats the two constituent parts phrase at page 193.

³⁷ Proposing Release at 170-71.

³⁸ In discussing the marketing and service fee, the Proposing Release states: "Although the [marketing and service] fee could be used for any type of distribution cost, we anticipate it primarily would be used to pay for servicing fees of the type currently permitted by the NASD sales charge rule, trail commissions to broker-dealers selling fund shares, and other expenses, such as fees paid to fund supermarkets that may in part be distribution related." Proposing Release at 38.

³⁹ Proposing Release at 105 and 150. The proposed General Instructions to Form N-1A would define an asset-based distribution fee as "a fee deducted from Fund assets to finance distribution activities pursuant to rule 12b-2(b) ('Marketing and Service Fee'), rule 12b-2(d), or rule 6c-10(b) ('Ongoing Sales Charge')." Proposing Release at n.413.

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Commission expressly recognized this “distinction between ‘sales charges’ and ‘service fees.’”⁴⁰ Historically, the Commission, the Staff and funds have treated Service Fees as fees which could be paid pursuant to Rule 12b-1 Plans but also as fees which, depending on the circumstances, could be paid outside Rule 12b-1 Plans. The approach to Service Fees taken in the Proposing Release creates uncertainty whether Service Fees under those same circumstances could be distinguished from the Rule 12b-2 marketing and service fee and paid outside of Rule 12b-2.

The Proposing Release acknowledges that there are some kinds of services which are not distribution related and for which a fund may pay either by using the marketing and service fee or outside of Rule 12b-2. For example, it states:

Today, some funds may pay for certain services (*e.g.*, sub-accounting fees to a retirement plan administrator) in the form of a “rule 12b-1 fee,” while others pay for the same service as an ordinary fund operating expense and account for the expense as “other expenses” in the operating expenses portion of the current fee table. Similarly, under our proposed approach, some funds are likely to treat expenses for the same service as a “marketing and service fee” or “other expenses.”⁴¹

In addition, by acknowledging that intermediaries in some circumstances may receive marketing and service fees without having to register as broker-dealers, the Proposing Release recognizes that there are some services for which a marketing and service fee may be paid which are not distribution related services.⁴²

It is not clear from the Proposing Release whether these non-distribution services include only those referred to above as administrative services or whether they also include Shareholder Services. The Proposing Release observes only that:

Fund expenditures under current 12b-1 plans often pay for a mixture of distribution and administrative services. For example, some funds may pay their entire fund supermarket fee under a rule 12b-1 plan, even though portions of the fee may pay for administrative services that are not distribution related. . . .

⁴⁰ See, *e.g.*, 34-29070 at 6.

⁴¹ Proposing Release at 100.

⁴² The Proposing Release notes that “receipt of the fees addressed in this Release *may*, depending on the service provided, require the recipient to register as a broker-dealer” and that while ongoing sales charges paid to an intermediary would require the intermediary to register as a broker-dealer, “[m]arketing and service fees paid to an intermediary *may* . . . require the intermediary to register.” Proposing Release at nn.9 & 168 (emphasis added).

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Similarly, proposed rule 12b-2 would not preclude funds from paying for these types of mixed expenses under rule 12b-2. However, to the extent that funds need not rely on proposed rule 12b-2 to charge expenses that can clearly be identified as not distribution related (*e.g.*, sub-transfer agency fees), funds could instead characterize those expenses as administrative expenses and thus keep total asset-based distribution fees within the 25 basis point limit of the marketing and service fee.⁴³

We believe the same approach should be taken with respect to administrative service fees and to Service Fees. The NASD intended Service Fees to be paid solely for activities that do not constitute “sales or sales promotion” services.⁴⁴ Taking the position suggested by the Proposing Release that all Service Fees are distribution related means concluding that the kinds of activities for which they may be paid do not involve “sales or sales promotion” but, nevertheless, are activities which are “primarily intended to result in the sale of shares issued by a fund.”⁴⁵

To avoid this incongruous result, Service Fees should be treated in the same way as administrative fees. If funds can identify the activities for which Service Fees are being paid as clearly not distribution related, they should be permitted to pay these fees outside proposed Rule 12b-2. If funds are paying for a mixture of distribution and service activities, they should be permitted, but not required, to pay for all of those activities with the proposed Rule 12b-2 marketing and service fee. This position would permit funds to continue with the various approaches that they currently take with respect to Service Fees and avoid the adverse consequences that the Commission has acknowledged could follow from a disruption of existing arrangements.⁴⁶

⁴³ Proposing Release at n.153.

⁴⁴ As noted above, the NASD intended that there be “clear distinction” between Service Fees and “asset-based sales charges,” which are defined as payments made “to finance sales or sales promotion expenses.” NTM 93-12 at Q. 23; NASD Conduct Rule 2830(b)(8).

⁴⁵ Proposed Rule 12b-2(e)(2).

⁴⁶ In the Proposing Release (at n.459), the Commission recognized the importance of preserving existing arrangements:

Because these payments [Service Fees and fees paid in connection with fund supermarkets and retirement plans] represent an integral part of many funds’ distribution strategies, we believe that significantly restricting the ability of funds to continue to pay for these ongoing services through fund assets would likely disrupt existing distribution systems, impose significant costs on funds and intermediaries, and may have other unintended consequences that could adversely affect funds and fund shareholders.

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The discussion of Service Fees in the Proposing Release is not necessarily inconsistent with this position. That discussion, however, reflects primarily the decisions made by funds that have elected to use their Rule 12b-1 Plans to pay for a mixture of distribution and service activities and gives little attention to those funds that have identified service activities that are not distribution related and elected to pay for them outside their 12b-1 Plans. The Boards of the funds in the latter category have made decisions based on the distinctions which the NASD intended to, and which the Commission and its Staff have acknowledged, exist between distribution activities, for which funds pay with sales charges and 12b-1 distribution payments, and shareholder service activities, for which funds pay with Service Fees.⁴⁷ We believe that the discussion in the Proposing Release may call these decisions into question.

Conclusion

In light of the foregoing, we believe that it would be appropriate for the Commission, in proceeding with the Proposal, to clarify that a fund is entitled to pay an NASD Conduct Rule 2830 Service Fee outside of Rule 12b-2 to the same extent that such a fee may currently be paid outside of Rule 12b-1.

* * * * *

Please direct questions and requests for additional information to John W. Blouch at 202-906-8714 (jblouch@dymema.com) or to Bruce W. Dunne at 202-906-8712 (bdunne@dykema.com).

Very truly yours,

Dykema Gossett PLLC

⁴⁷ The Commission has stated that whether any payment of a fee by a fund is for distribution services or non-distribution services is a question of fact for the fund's Board to determine. IC-16431 at nn.129 & 173. The Staff has reiterated this position: "Whether a fund's payment of part or all of a supermarket fee must be made pursuant to a rule 12b-1 plan depends on an analysis of the purpose for which the payment is made. The determination of the purpose of the payment must be made by the fund's board of directors and requires careful consideration and monitoring." *Investment Company Institute*, note 26, supra. Under the Proposal, directors would have an obligation to oversee the amount and use of a fee in the same manner whether the fee is paid pursuant to Rule 12b-2 or outside the rule as an other fund operating expense. Proposing Release at 42-43.