

ICI Recommends Refinements to Rule 12b-1, July 2007

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Focus on Improving Investor Understanding and Board Oversight of Fee

Stresses Role of Fee in Bringing Choice, Advice, and Other Essential Services to Investors

Washington, DC, July 19, 2007 – The Investment Company Institute today made several recommendations for refining the regulations governing the use of 12b-1 fees. ICI made the recommendations in response to a comprehensive Securities and Exchange Commission [review of 12b-1 fees](#).

In a letter delivered to the Commission today, the Institute recommended improved disclosure to give shareholders a better understanding of the nature of the fee and clarification of the responsibilities of mutual fund boards in approving and overseeing 12b-1 plans. The Institute also stressed the importance of a rigorous economic analysis of any proposed changes to determine the cost and benefit to investors and the fund industry.

ICI urged the SEC to consider improving both the disclosure provided by funds in the prospectus and other documents, and by intermediaries at the point of sale. The Institute suggested that 12b-1 fees be identified in a manner that describes their purpose rather than being identified by reference to an SEC rule. And it advised that any point-of-sale disclosure requirements not create competitive disadvantages by imposing regulatory obligations only relating to mutual funds. A heavier regulatory burden on funds could encourage intermediaries to steer clients to alternative investments that do not offer the same level of protection, diversification, and liquidity as funds.

The Institute further urged the SEC to revisit the responsibilities of boards because the existing guidance has long been outdated and is not consistent with the current uses and market realities of

12b-1 fees. In particular, the ICI called for the SEC to update or eliminate the original nine factors devised to help boards evaluate 12b-1 fees, and/or eliminate the quarterly board reporting requirements.

While suggesting refinements to Rule 12b-1, ICI urged the Commission to retain its basic framework, calling it integral to the structure of the mutual fund industry and to the delivery of advice and other services that fund investors consider absolutely essential.

“Rule 12b-1 is an integral part of the structure and success of the mutual fund industry,” ICI Acting General Counsel Mary Podesta wrote in the letter. “The rule and its associated fees allow investors the option of paying distribution costs over time, give investors access to funds that otherwise might not be available to them, and compensate financial intermediaries, on whom so many fund investors depend.”

Over 70 percent of funds today use 12b-1 fees to serve shareholders who prefer to buy advice and other services over time. The flexibility of Rule 12b-1 has increased the choices available to investors and helped spark the intense competition that is a hallmark of the fund industry. Small fund companies have the ability to access distribution channels that might otherwise be unattainable for them without 12b-1 fees.

Urging the SEC to refrain from radical overhaul or the elimination of Rule 12b-1, ICI’s Podesta wrote, “These changes would limit investor choices, increase barriers to entry in the industry, cause shareholders to pay higher taxes on their funds, and impose significant operational and transitional costs on funds, intermediaries, and investors.”

ICI raised strong objections to suggestions raised at an [SEC roundtable in June](#) to “externalize” the fee, assessing it at the individual account level rather than deducting it from fund assets. Proponents have argued that an account level charge would make the fee more transparent and allow investors to more easily make price comparisons. The ICI countered that externalization would increase investors’ tax costs, reduce the tax efficiency of funds, and require extensive overhaul of fund operating and recordkeeping systems.

“There are significant tax and operational disadvantages to imposing 12b-1 fees at the account level that likely would outweigh the benefits of this approach,” Podesta wrote. The improved disclosure requirements offer a far better way to increase investors’ understanding of 12b-1 fees.

ICI has demonstrated that 12b-1 fees have become an integral part of the system of choice that investors rely upon to pay for advice and other ongoing services. According to [an ICI study](#), in 2004 the bulk of 12b-1 fees were paid to compensate brokers and financial advisers for ongoing shareholder services (52 percent) and for initial assistance in a fund purchase (40 percent). Only 2 percent of the fees were used to pay for promotion and advertising of funds. A [separate ICI study](#) found that more than 80 percent of mutual fund investors outside retirement plans rely upon professional advice in making key fund investment decisions.

The Investment Company Institute (ICI) is the national association of US investment companies. ICI members include 8,766 open-end investment companies (mutual funds), 670 closed-end investment companies, 440 exchange-traded funds, and four sponsors of unit investment trusts. Mutual fund members of the ICI have total assets of approximately \$11.242 trillion (representing 98 percent of all assets of US mutual funds); these funds serve approximately 93.9 million shareholders in more than 53.8 million households.

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