Aladdin, Vicki T.

ES 120824

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From: John Robinson [robinsons003@hawaii.rr.com]
Sent: Saturday, June 16, 2007 5:22 AM
To: CHAIRMANOFFICE
Subject: RE: SEC Rule 12b-1 Round Table Panel #4 -- Please forward to Mr. Andrew Donohue...

Dear Mr. Donohue:

Thank you for taking time to acknowledge receipt of my April 29, 2007 letter in which I expressed concern in the wake of your March 26, 2007 public statements on SEC Rule 12b-1. As you suggested, I have continued to follow the issue closely and have submitted three public comment letters to the SEC in advance of the June 19, 2007 Rule 12b-1 round table.

Since you are the moderator of the panel discussion that plans to address 12b-1 reform options (Panel #4), I felt compelled to pass along some of my concerns to you directly. To begin, as expressed in one of my public comment letters, I am concerned that at least two of the panelists in your group – Don Phillips and Barbara Roper - have long been outspoken critics of Rule 12b-1 (See Morningstar's April 19, 2007 self-published article, ***"Memo to SEC: 12b-1 Fees Must Go"*** and Consumer Federation of America's 2004 public commentary to the SEC). While I do not object to their inclusion in the debate per se, I am troubled that the Financial Planning Association (FPA) and the financial advisor community in general appear to have been entirely excluded from the round table. In my opinion, the exclusion of these groups detracts from the fairness and balance of the debate. Further, while I have tremendous respect for Don Phillips and for Morningstar, it should be publicly acknowledged that Morningstar, as a company that primarily serves self-directed investors, is not unbiased it its views and stands to gain considerably from the repeal of Rule 12b-1.

In terms of the specific issues to be addressed in Panel #4, my suggestions for Rule 12b-1 reform are provided below as excerpted from my public comment letter. Thank you again for your time and consideration.

Respectfully,
John H. Robinson
Honolulu, Hawaii

III. Practical 12b-1 Reform Measures for Consideration

Although the focus of this discussion thus far has been in pointing out the problems and dangers of radical reform or repeal of Rule 12b-1, an objective review of current applications of the rule suggests that there may be some areas that could benefit from reform. Potential reform measures are as follows:

- Simplify and improve disclosure of fees and conflicts of interest. As mentioned previously, this was the top recommendation of the NASD's Mutual Fund Task Force. Given that a wide body of research finds that investors are ignorant about the 12b-1 fees and find the primary disclosure document, the prospectus, to be overly complex and intimidating, transparency is clearly an issue that should be addressed. One simple solution might be to require a clear, concise statement regarding the amount and purpose of 12b-1 fees to be printed on client confirms and to require the fund companies or brokerage firms to issue a simple one page disclosure statement to investors each year. For investors with multiple funds, a single carefully crafted disclosure statement might be used to cover all holdings.

- Impose a moratorium on the issuance of Class B mutual fund shares. Class Ashares with an up front sales charge are broadly accepted as suitable for investors who wish to employ a financial advisor, particularly for large breakpoint eligible investments. Similarly, an academic case can be made that the quasi asset-based fee compensation structure of Class C shares may benefit investors by better aligning advisor and client interests than commission-based alternatives. Conversely, it is generally accepted that the set of circumstances in which Class B shares benefit investors over other share classes is extremely limited. Further, the history of the evolution of mutual fund share classes suggests that an unwritten motivation behind the introduction of Class B shares was to hide the impact of up front commissions from investors in order to make fund purchases appear to be equivalent to no-loads. The time may be at hand to admit that this share class represents an evolutionary wrong turn. However, if B shares are slated for elimination, consideration should be made of existing financing agreements at the fund companies. A moratorium on new B share issuance would address this problem and assure the elimination of this share class over time as existing B shares are converted to A shares at the end of their stated CDSC periods.

- Amend and standardize the Class C share compensation structure. At present, most Class C share mutual funds pay the selling brokerage firm a 1% up front commission with a 1% trailing 12b-1 service fee commencing after 12 months. A 1% contingent deferred sales charge typically applies for funds sold within 12 months of purchase. This fund structure has appealed to many financial advisors because it aligns advisor and client interests in much the same way as an advisory asset-based wrap fee account does. For example, if the need arises, an advisor can objectively recommend switching from one fund to another (assuming the fund has been held at least 12 months), since the advisor receives no additional financial gain from the transaction. However, due to the presence of the 1% fronted commission and the 1% CDSC, C shares still retain elements of a commission-based sales structure. A superior compensation structure for Class C shares might be one that pays the advisor nothing up front, levies no CDSC on the investor, and simply pays the advisor an ongoing 1% 12b-1 fee from inception. As long as the fee is clearly disclosed and the fund is not presented as a no-load, this structure, which has already been adopted by a handful of mutual funds, seems superior to the current Class C structure.

- Require reimbursement of 12b-1 fees paid on mutual funds in multi-manager401(k) and 403(b) platforms and in mutual fund wrap accounts. It is well known within the financial services industry that many financial institutions that administer multi-manager 401(k) and 403(b) platforms (primarily large insurance companies) collect 12b-1 fees in the platform in addition to their stated administrative service fees. Disclosure of this fact is typically buried in the employer documents and is rarely disclosed to plan participants in any clearly quantifiable manner. This is a murky issue that might easily be addressed by forcing plan sponsors to either reimburse participant 12b-1 fees or use 12b-1 fees to offset the administrative service fee. Such double dipping also likely exists in some investment advisory wrap account programs, though many fund custodians seem to have elected to reimburse 12b-1 fees to investor accounts.