charles SCHWAB

July 16, 2007

Ms. Nancy Morris, Secretary
U.S. Securities and Exchange Commission
100 F Street, N.W.
Washington, D.C. 20549

File Number: 4-538

Dear Ms. Morris:

Thank you for the opportunity to participate in the June 19, 2007, Roundtable on Rule 12b-1, and for the opportunity to submit these written comments. Charles Schwab & Co., Inc., one of the nation's largest financial services firms, was founded more than 30 years ago as a pioneer in discount brokerage. Today, we are a full-service firm serving more than 7 million accounts with nearly $1.4 trillion in client assets.

Mutual funds have long been at the core of our business. We launched our Mutual Fund Marketplace®—the first mutual fund supermarket to focus on no-load funds—more than 20 years ago, and in 1992 we launched Schwab's Mutual Fund OneSource®—the first no-load, no-transaction fee supermarket. Today, Schwab clients can choose from among more than 4,000 mutual funds from 450 fund families, including 2,600 OneSource funds that have no loads and no transaction fees, in the Schwab Mutual Fund Marketplace®. Currently, Schwab clients have approximately $446 billion invested in mutual funds.

At Schwab, we believe strongly that few innovations have had as dramatic a benefit to investors as the development of mutual fund supermarkets. They have democratized mutual fund investing by increasing the choices available to investors, allowing literally thousands of small funds to find space in the marketplace. Supermarkets have helped keep costs down, allowed investors to compare funds in order to make better-informed decisions, and made investing in mutual funds simple and, not coincidentally, wildly popular. Statistics underscore the significant influence mutual supermarkets have had on the mutual fund industry. According to the Investment Company Institute, the number of mutual funds rose from 3,824 in 1992 (the year Schwab launched OneSource®) to 8,210 at the end of 2006[1]. Assets invested in those funds have skyrocketed from $1.6 trillion to $10.4 trillion over the same period[2]. And more than twice as many households own shares of a mutual fund today (54.9 million) as did in 1992 (25.8 million)[3].

We believe supermarkets also have been a significant factor in bringing down operating expense ratios and fees, much to the benefit of the individual investor. Data shows that average fees and expenses incurred by investors in stock funds in 1990 were 1.98 percent, but had declined to

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[1] Investment Company Institute, *2007 Investment Company Fact Book*, at 93.
[2] *2007 Investment Company Fact Book*, at 95.
[3] *2007 Investment Company Fact Book*, at 58.

1.07 percent by 2006[4]. The competition brought about by supermarkets has made it critical for a fund to keep its expenses as low as possible, particularly since funds can be compared by their expenses and fees to each other.

One of the main cogs of this engine has been Rule 12b-1, which is one of the mechanisms by which fund companies pay reasonable fees to brokers for the various services they provide to funds and fund shareholders. We welcome the Commission's interest in determining whether Rule 12b-1 remains effective and in exploring ways in which it can be improved, particularly when it comes to making fees more transparent and understandable to investors.

Overview

Schwab believes that Rule 12b-1 is in need of some changes, but that repealing or dramatically changing it would not be in the best interests of the nearly 100 million Americans who invest in mutual funds. We do, however, support some modest changes that would make the fees more transparent and understandable to investors. In this written submission, which complements my participation in the June 19, 2007, Roundtable discussion, I will outline the benefits of mutual fund supermarkets to investors and to the mutual fund industry as a whole; discuss the services we provide as operator of one of the largest and oldest mutual fund supermarkets in the country, how we are compensated for those services, and how we communicate that information to investors; and, finally, make recommendations for areas in which the SEC should take action to improve Rule 12b-1.

Importance of Mutual Fund Supermarkets

Mutual fund supermarkets like Schwab Mutual Fund Marketplace® and OneSource®[5] have dramatically revolutionized and democratized investing. Supermarkets have provided investors with a vast array of investment choices that previously were not available, including funds that specialize in every conceivable sector. Supermarkets have allowed investors the ability to comparison shop among thousands of different funds from different fund families and to compare funds across a wide variety of categories, including among other factors performance, risks, fund expenses, investment strategy, portfolio turnover rates, and fund manager tenure.

Before the advent of supermarkets, if an investor wanted to purchase funds offered by different fund families, the investor had to open an account at each fund family. If they wanted to review their portfolio holdings, they would need to review the multiple quarterly statements sent by each fund family for all of those separate accounts. And if they wanted to transfer assets from one fund to another, they had to submit a request to do so, wait for the redemption proceeds to be sent to them, open up a new account, and then request a purchase of fund shares. This was a time-consuming, cumbersome and inconvenient process. Moreover, prior to fund supermarkets, comparison was difficult, and many investors were not even aware of the wide variety of funds available. Simply put, fund supermarkets make buying and selling mutual funds easier for

[4] *2007 Investment Company Fact Book*, at 48.

[5] OneSource, our supermarket of no-load, no-transaction fee funds, is a subset of the Schwab Mutual Fund Marketplace, which includes not only OneSource funds, but also thousands of funds available for purchase subject to transaction fees and/or sales loads.

investors. At Schwab, clients can use multiple channels– telephone, Internet, wireless, or in-person – to buy and sell thousands of different mutual funds, and can easily sell one fund and buy another with the proceeds in a seamless transaction.

Consistent with long-standing SEC policy, Schwab believes the best investor is an informed investor, so our philosophy has always been to make available the most information possible. Through fund supermarkets, investors have access to unparalleled investment tools, research and customer support to assist them in identifying funds that match their investment goals and risk tolerance. Keeping track of multiple funds is also greatly simplified, since supermarkets allow clients to see all their assets, across all funds and fund families, on a single web page or printed statement. This eases tax reporting as well, as all the information necessary for filing Schedule D on an individual tax return is compiled in a single form.

Mutual fund supermarkets have also been very important to the health of the mutual fund industry. Smaller, entrepreneurial funds and fund families have flourished in the last decade because supermarkets have given them access and exposure to millions of investors – potential shareholders that they simply never could have reached on their own. Fund companies leverage the fund supermarket's existing and often superior shareholder servicing and other processing infrastructure, providing shareholders with a far better investor experience than can be provided directly. Start-up funds lack the resources to create a proprietary infrastructure, but perhaps the more important point is, why should they? The service model offered by fund supermarkets is established, strong, dependable and far superior to anything a small fund company could provide. Participating in a supermarket allows funds to put their energy and resources where it matters most: managing assets.

Our own experience at Schwab has shown that these benefits have made investing in mutual funds very popular. In 1993, there were about 835,000 Schwab accounts that held about 1.9 million positions in mutual funds – today, that number has risen to more than 4.2 million accounts and about 13.5 million positions. The assets invested in mutual funds has risen from about $25 billion to $446 billion over the same period. Our clients are clearly finding that mutual funds are a critically important investment vehicle, and we believe that the broad array of choices they have in our supermarket is the driving factor behind that growth.

Schwab's Supermarket: What We Do, What We Don't Do, and How We Are Compensated

As operator of the Schwab Mutual Fund Marketplace®, we at Charles Schwab offer a total package of services for investors who wish to invest in mutual funds, from account opening to account closing and everything in between. When we speak of "shareholder services," it is this broad range of services that we are referring to. These shareholder services include the execution and settlement of fund transactions, the distribution of dividends, processing of transfers, and preparation and mailing of trade confirmations and account statements. We also send and make available fund prospectuses, annual reports, and other regulatory communications to fund investors. We maintain account and transaction information and history, provide customers with electronic access to that information, and send tax reporting information to the investor. We maintain call centers (accessible 24 hours a day, 7 days a week) and branches to support greater investment access and account service questions.

In addition to all these shareholder services, Schwab also maintains a robust, state-of-the-art web site through which investors can access and manage their accounts, effect transactions, transfer funds, and elect complimentary services (such as electronic delivery options and other account preferences). On our website, investors also can research thousands of funds and compare those funds to each other in numerous ways. We also offer a variety of other research tools, including Morningstar ratings, analyses of fund historical performance, in-depth analysis of specific funds, and a Fund Screener that allows individuals to choose from among those funds that meet a particular set of investor-specific criteria. We also have professionals available via the phone or via an in-person visit to a Schwab branch, who can provide assistance to customers in helping them meet their investing goals.

Schwab also provides a variety of record-keeping and other administrative services to the funds directly. Because Schwab typically transacts on an omnibus basis, Schwab performs all of the back-office processing that would otherwise need to be performed by the Fund. For example, Schwab aggregates all customer transactions on a daily basis so that the Fund receives a single purchase and redemption order rather than thousands. Schwab maintains shareholder records and provides various reporting to the funds to assist the funds in monitoring and enforcing fund policies. From all of these and other services Schwab provides to the funds and its shareholders, funds benefit from savings on transfer agent costs and from the scale of omnibus account services.

For OneSource funds—those funds our customers can purchase and redeem without paying a transaction fee or sales load—Schwab generally charges the funds an annual service fee equal to 40 basis points (0.40%) of the average fund assets held at Schwab. Funds may pay all or a portion of the OneSource fees directly from fund assets, through a Rule 12b-1 plan, a shareholder servicing plan, or a combination thereof. In some cases, a portion of the fee is paid by the fund's investment adviser or other fund affiliate out of their legitimate profits. We believe the manner in which a fund decides to pay our fees is a matter best left to the fund's board. We do not require funds to pay those fees in any particular fashion, nor do we ask the manner in which the fund structures those payments, so we don't know definitively as to any one fund what portion of its fees it pays to us under a 12b-1 plan and what portion it pays outside of such a plan. That said, while we don't know the exact amount of supermarket fees that are paid to Schwab under a 12b-1 plan, our best estimate is that about 40% of the total fees paid to Schwab from OneSource funds are paid pursuant to a Rule 12b-1 plan.

There is, of course, nothing that precludes a fund company from paying shareholder service fees to Schwab (or any other service provider) out of fund assets. But while funds do have the ability to pay for shareholder services fees directly from fund assets, in practice it can be difficult in some cases to distinguish definitively those services that constitute distribution services from those that are shareholder services. Thus, even if a fund board reasonably determines that a supermarket fee represents payment for shareholder servicing, it may be reluctant to pay such fees out of fund assets in the absence of clear regulatory guidance that no portion of supermarket fees represent payment for distribution. Without such guidance, and without the ability to rely on rule 12b-1 as a mechanism through which to pay service fees (which is clearly permissible under the current regulatory structure), some funds may have less flexibility to participate in fund supermarkets to the detriment of investors. Rule 12b-1 provides fund boards flexibility to make the best decision about how to structure payment for these services provided to the funds. And any change that limits or prevents any fund's ability to participate in fund supermarkets can only be seen as a detriment to investors and the growth of the mutual fund industry.

It is important when discussing the services that Schwab provides to note as well the kinds of services that we do not provide. Most importantly, Schwab does not provide promotional, marketing, advertising or similar types of distribution-related services on behalf of any third-party fund or fund company, nor is Schwab in any way obligated to do so. The fees that Schwab receives from funds participating in our Marketplace are not payments for "shelf space," placement on a preferred list, or any other kind of special recommendation or treatment. All funds available through our Marketplace must compete with each other on their merits.

From the investor's perspective, Schwab has always believed strongly in clear and robust disclosure, particularly around fees. Every fund in our supermarket has the 12b-1 fees clearly marked, in its own category, as part of the Fund Facts & Fees tab on our web site. Funds can be compared to each other on the basis of total fees and/or 12b-1 fees. As we explain in our recommendations below, however, we believe that further clarity can be achieved in the area of fee disclosure, to the benefit of investors.

Recommendations for SEC Action

We believe that the benefits of supermarkets to both investors and the fund industry are so important that the SEC's overarching goal in examining Rule 12b-1 should be preservation of this remarkably democratizing way of ensuring that investors have access to thousands of different funds. We need to be particularly thoughtful with respect to any change in Rule 12b-1 and wary of the adverse unintended consequences such change might impose on investors. In our view, repealing or dramatically changing Rule 12b-1 is not in the best interests of the nearly 100 million Americans who invest in mutual funds. Repeal of Rule 12b-1 would undoubtedly restrict a fund's ability to rely on supermarkets and their superior infrastructure, and, in particular, we believe it would have a disproportionate impact on smaller and new funds that lack the resources outside of fund assets to pay for shareholder servicing. The rule is one reason that mutual fund supermarkets have flourished, resulting in much more choice of funds for investors. The barriers to entry that would exist if Rule 12b-1 were eliminated are simply a bad outcome for investors – it would mean fewer investment choices. Fewer choices and less competition would also likely result in higher costs to investors.

For these reasons, we believe that Rule 12b-1 should be retained in similar form to its current state. However, we do believe that there are places where improvement is warranted, and we would support changes along these lines.

1. *Increased transparency and improved disclosure* – As has been recommended by the Working Group on Rule 12b-1, convened by the Investment Company Institute, we support removing the jargon of "12b-1 fees" and providing a more descriptive, plain English way of describing these fees so that investors are better able to understand their purpose. We would encourage that the fee disclosure be accompanied with clear

explanations and examples of the range of services for which the fees are intended. We also support the ICI recommendation to include a glossary of terms used in the prospectus fee table that defines, in simple language, key terms such as sales load, management fees, transfer agent fees, shareholder service fees, and distribution fees.

2. *Improved fund board guidance* – The nine suggested 12b-1 factors found in the adopting release are now more than 25 years old and are outdated. They should be eliminated, and the SEC should provide more flexible, up-to-date guidance for what fund directors may want to consider when reviewing 12b-1 plans, particularly in light of how those fees are most often used today.

In crafting these changes, it is critical to ensure that no changes mislead investors by highlighting one aspect of fund expenses over another; that no changes restrict or limit a fund's ability to rely on the infrastructure and superior shareholder services provided by fund supermarkets; and that no changes place funds at a competitive disadvantage or stifle the ability of smaller or entrepreneurial funds to complete in the marketplace. Finally, any regulatory changes should give careful consideration to how they interact with other aspects of the securities industry and current regulatory structures, so that mutual funds in general are not disadvantaged when compared to other investment vehicles. There is no question that the growth of the mutual fund world has been of great benefit to investors, and that mutual fund supermarkets have been a critical factor in that growth. The SEC should take care to preserve the strengths of the mutual fund marketplace that have developed over the last quarter century, to the great benefit of individual investors.

Thank you again for the opportunity to participate in this important dialogue. If you have additional questions, please do not hesitate to contact me.

Sincerely,

John Morris
Senior Vice President