

NAPFA Comments, 12b-1 Fees



July 17, 2007

Nancy M. Morris, Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090.

Re: File Number 4-538

Dear Secretary Morris:

On behalf of the National Association of Personal Financial Advisors (NAPFA) Board of Directors, we thank the U.S. Securities and Exchange Commission for the opportunity to submit these comments. NAPFA is the nation's leading organization of Fee-Only® comprehensive financial planning professionals. All NAPFA members adhere to a fiduciary oath to exercise their best efforts to act in good faith and in the best interests of their clients. NAPFA-Registered Financial Advisors adhere to the three basic principles – comprehensive planning, professional competency, and Fee-Only® compensation.

We believe that individual investors are confused about the purpose of 12b-1 fees and their impact upon their own returns. Likewise, individual investors nearly always fail to understand the “total fees and costs” involved in owning mutual funds. To correct this, we urge the Commission to consider the following:

1. Enhanced Descriptors and Disclosures of 12b-1 Fees. 12b-1 fees are utilized to pay for a variety of expenses, from servicing of shareholder accounts to compensation for broker-dealer firms. We urge the Commission to examine the appropriateness of each expense paid by 12b-1 fees, and to require full disclosure of each and every separate item of expense.
 - a. Renaming 12b-1 fees in more precise descriptive language, such as “brokerage firm compensation” or “brokerage firm reimbursement for account maintenance expenses,” would be helpful to individual investors.

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- b. When 12b-1 fees are utilized to fund a variety of distribution-related expenses, these expenses should be broken down into sub-categories for each area of expense.
 - c. Timing of disclosure is important. In addition to point-of-sale and/or point-of-recommendation disclosures (see discussion below), disclosures of a mutual fund's "total fees and costs," including 12b-1 fees, should be reflected in quarterly account statements.
 - d. It is imperative that individual investors be informed if the 12b-1 fee of a fund is perpetual, or whether a Class C share may be converted to a Class A share following a certain number of years, and whether this conversion is automatic or must be requested.
2. Point-Of-Recommendation and Point-Of-Sale Disclosures. In conjunction with current U.S. Department of Labor initiatives to promote fuller disclosure of fees in ERISA plans, NAPFA urges the Commission to further consider promulgation of a rule for point-of-recommendation or point-of-sale disclosures. In addition to clearer disclosure of 12b-1 fees, NAPFA suggests the inclusion of transaction costs on such disclosure statements. To this end, NAPFA proposes a format for disclosure, set forth as Exhibit A hereto. For information on the "hidden costs" of variable annuity sub-accounts, mutual funds, and other pooled investment vehicles, please refer to Exhibit B.

In formulating this disclosure format, NAPFA's working group defined the following general principles:

- The fee disclosure form itself should be written in plain English, to the extent possible.
- Definitions of terms should be provided on a separate page to correct the issue of fees and costs associated with investing being described in terms which are unfamiliar to most individual investors.
- The form's design should be easy to read and understand. The font should be in a size that can be easily read. Colors should be used differentiating sections. We encourage the Commission to employ graphic designers to enhance readability and consumer understanding of disclosure forms. This would include establishing a standard for the quality of paper used to assure that the type is readable by the investor.

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NAPFA further recommends that the disclosure document be distributed as follows:

- At the time of recommendation of the investment to the individual consumer;
- At the time of sale of the investment to the individual consumer; and
- Annually.

In addition, and as stated above, fund fees should be disclosed quarterly to the fund shareholder, by notation of the total fees and costs on brokerage or fund quarterly statements.

Additionally, the fee and cost disclosure document should be made available on any web site which may be provided to fund shareholders for purposes of accessing their accounts, with clear links provided to the summary disclosure document found on each page of the brokerage firm's or mutual fund company's web site.

In lieu of delivery of more comprehensive written disclosure documents, such as a fund's Prospectus, Statement of Additional Information, and Annual Report, these documents could be made available on the web site maintained by the mutual fund company or brokerage firm at which the shareholder's account is maintained. We note that all too often one or more of these reports are not actually made available on mutual fund web sites; hence, compliance with web access to these reports should be more strictly monitored. However, we believe the summary disclosure document, of the type attached as Exhibit A, should be provided as a hand-delivered or mailed written document, at the times indicated as set forth above.

In summary, consumer understanding of the full cost of a fund's expenses is an essential aspect of the information required for consumers to be able to make sound investment decisions. We believe that the "total fees and costs" of mutual funds, and the purposes to which such fees and costs are utilized, should be disclosed.

The term "12b-1 fees" fails as a descriptor of the many different types of fees and costs which may be covered; better disclosures on the use and impact of 12b-1 fees should be mandated, in addition to the use of new terminology. Finally, given the substantial evolution in the use of 12b-1 fees over the past few decades, the propriety of the use of

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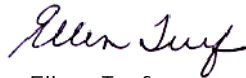
such fees to pay for certain types of services should be closely examined by the Commission.

Again, the National Association of Personal Financial Advisors thanks the U.S. Securities and Exchange Commission for the opportunity to submit these comments. As the nation's leading organization of fiduciary financial advisors, we are available to respond to questions or lend further assistance as the Department may desire.

Sincerely,



Richard Bellmer
Chair, NAPFA



Ellen Turf
CEO, NAPFA

Contact information:

Ellen Turf, CEO
National Association of Personal Financial Advisors (NAPFA)
3250 North Arlington Heights Road, Suite 109
Arlington Heights, IL 60004
Phone (toll-free): 800-366-2732
Phone: 847-483-5400
Facsimile: 847-483-5415
E-mail: turfe@napfa.org

EXHIBIT A: PROPOSED DISCLOSURE FORMAT

(NAME OF MUTUAL FUND)

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The Fees That You Pay In Connection With This Mutual Fund or Variable Annuity Sub-Account and/or Your Retirement Plan

Academic evidence suggests that, on average, investment products with higher fees underperform similar investment products with lower fees.

PART ONE: Fees You Pay When You Buy (Sales Loads)

This is the amount you pay “up front” as sales fee (or “load”) for Class A mutual fund shares. This is expressed as a percentage of the amount you invest. The table at right enables you to calculate the actual amount of this sales fee, based upon the amount you place in this fund.

The impact of this up-front sales fee upon your investment returns is dependent upon how long you hold this investment. The impact of the 5.75% sales fee is summarized as follows:

Assuming a 7% annual rate of return, the 5.75% sales fee reduces your annualized return by the following percentage each year, on average:

1 year	___%
3 years	___%
5 years	___%
7 years	___%
10 years	___%
15 years	___%

The amount you invest:	<input type="text" value="\$ 1,000"/>
X the percentage sales fee	<input type="text" value="x 5.75%"/>
= the amount of your sales	<input type="text" value="= \$ 57.50"/>

Sales loads (are/are not) imposed upon reinvested dividends from the fund and reinvested capital gain distributions from the fund.

PART TWO: Fees You Pay Each Year In Connection With This Fund

Annual annuity mortality/expense charges:
 ___%
 Annual fund 12b-1 distribution fees:

For an explanation of each of these fees, see pages 3-4.
 * Annual fund brokerage commissions paid are estimated based upon the prior years' commissions paid by the fund. Current and

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<p>____%</p> <p>Annual fund management fees:</p> <p>____%</p> <p>Annual fund administrative charges:</p> <p>____%</p> <p>Annual fund brokerage commissions paid*:</p> <p>____%</p> <p>Annual other fund transaction costs**:</p> <p>____%</p> <p style="color: red; text-align: center;">SUB-TOTAL ANNUAL FEES PAID EACH YEAR:</p> <p>____%</p>	<p>future year brokerage commissions paid by the fund may be higher or lower.</p> <p>** Annual "other fund transaction costs" include bid-ask spreads, market impact costs, principal mark-ups and mark-downs on fixed income trades, and opportunity costs due to delayed or canceled trades. These annual costs are estimated based upon methodologies approved by the U.S. Dept. of Labor; actual "other fund transaction costs" may be higher or lower each year.</p>
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(NAME OF MUTUAL FUND)
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The Fees That You Pay In Connection With This Mutual Fund or Variable Annuity Sub-Account and Your Retirement Plan

PART THREE: Fees You Pay If You Sell Your Fund Shares

<p>Should you sell fund shares which you have purchased prior to the date set forth below, you will pay a deferred sales charge as follows:</p> <p>If share is sold 0-1 years following purchase: ____%</p> <p>If share is sold 1-2 years following purchase: ____%</p> <p>If share is sold 2-3 years following purchase: ____%</p> <p>If share is sold 3-4 years following purchase: ____%</p> <p>If share is sold 4-5 years following purchase: ____%</p> <p>If share is sold 5-6 years following purchase: ____%</p> <p>If share is sold 6-7 years following purchase: ____%</p> <p>If share is sold 7-8 years following purchase: ____%</p> <p>If share is sold 8-9 years following purchase: ____%</p> <p>If share is sold 9-10 years following purchase:</p>	<p>You pay a sales fee for Class B shares when you sell them — at the back end. This fee varies with both the value of the shares you sell and the length of time you hold them.</p>
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___%

If share is sold more than 10 years
following purchase:

___%

The Impact of Fees and Expenses On Your Retirement Income. In a **investment** plan, your account balance will determine the amount of retirement income you will receive from the plan. While contributions to your account and the earnings on your investments will increase your retirement income, fees and expenses paid by your plan may substantially reduce the growth in your account. The following example demonstrates how fees and expenses can impact your account. Assume that you are an employee with 35 years until retirement and a current 401(k) account balance of \$25,000. If returns on investments in your account over the next 35 years average 7 percent and fees and expenses reduce your average returns by 0.5 percent, your account balance will grow to \$227,000 at retirement, even if there are no further contributions to your account. If fees and expenses are 1.5 percent, however, your account balance will grow to only \$163,000. The 1 percent difference in fees and expenses would reduce your account balance at retirement by 28 percent.

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PART FOUR: Other Fees and Expenses You Will Pay In Connection With This Retirement Plan

<p>Annual custodial fees: ____%</p> <p>Annual plan recordkeeping and administrative fees* : ____%</p> <p>Annual investment consulting/trustee fees: ____%</p> <p style="color: red;">SUBTOTAL OTHER PLAN FEES: ____%</p>	<p>* Annual plan recordkeeping and administrative fees are estimated based upon prior year's fees and are allocated to plan participants (pro rata based upon account balances) (equally based upon the number of participants)</p>
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PART FIVE: Other Fees and Expenses You May Pay In Connection With This Plan

Loan Fee	\$____ per loan
Other Fees (describe)	

Find Out More About The Risks, Goals, and Historical Returns of This Investment

Additional information on this fund can be found by carefully reviewing the fund's Prospectus, Statement of Additional Information, Annual Report, and semi-annual and quarterly reports. You may obtain this information by calling (800) 999-9999 or on line at www.____.com.

You should consider all the costs, goals and risks associated with any fund before you buy. Read about this information, along with historical returns, in the fund prospectus. Please note that past performance is not a guarantee of future returns. You may obtain a copy of the fund's prospectus by calling (800) 999-

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9999 or on line at www._____.com.

Find Out More About Conflicts of Interest

Various conflicts of interest exist between you and the brokerage firm, investment adviser, or mutual fund company who sold or recommended this plan to you. Information regarding these conflicts of interests and any fee-sharing or cross-payment arrangements can be obtained online at www._____.com or by calling (phone #).

(NAME OF MUTUAL FUND)

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The Fees That You Pay In Connection With This Mutual Fund or Variable Annuity Sub-Account and Your Retirement Plan

Definition of Terms:

Sales load (up-front sales charge).

Annual annuity mortality and expense charges.

Annual fund management fees.

Annual fund administration fees.

Annual fund distribution (12b-1) fees.

Annual fund brokerage commissions paid.

Annual other fund transaction costs (bid-ask spreads, market impact costs, opportunity costs due to delayed or canceled trades).

Annual fund opportunity costs due to average cash holdings in the fund.

Contingent deferred sales charge (surrender fee).

Annual custodial fees.

Annual plan recordkeeping and administrative fees.

Annual investment consulting/trustee fees.

[DEFINITIONS TO BE COMPLETED.]

EXHIBIT B: SHINING THE LIGHT ON “HIDDEN FEES AND COSTS”

Despite the principle that mutual fund shareholders and retirement plan participants should have clear information on the costs associated with investing through their defined contribution plans, current fund disclosures omit or obscure many of the “hidden” costs associated with investing or mislead as to their impact upon investor returns. The annual expense ratio of a mutual fund does not include the following real costs, fees, and expenses:

- Brokerage commissions and/or principal mark-ups/markdowns paid by the fund in connection with trading;
- Bid-ask spreads;
- Market impact costs;

Together these costs can often be as much as, or even greater than, the fund’s disclosed annual expense ratio. See Edelen, Evans and Kadlec, “Scale effects in mutual fund performance: The role of trading costs” (March 17, 2007), available at https://wpweb2.tepper.cmu.edu/wfa/wfasecure/upload/2006_1.870275E+07_WFA_TradingCosts_Text_NoName.pdf. The authors of this white paper provide the following summary:

[O]ur paper makes four empirical contributions to the literature:

- Mutual funds’ annual trading costs are larger in magnitude than the expense ratio. In contrast to the ambiguous relation between turnover and performance, annual trading costs bear a statistically significant negatively relation to performance.
- The negative impact of trading on performance is most pronounced for funds with a relatively large average trade size. Trading does not adversely impact performance at funds with a relatively small average trade size. Moreover, after controlling for trading costs fund performance is no longer related to fund size. Thus, trading costs are the dominant source of diseconomies of scale in investment management.
- Flow-driven trades are shown to be significantly more costly than discretionary trades in a much larger sample and longer sample period than previously documented. This nondiscretionary trade motive partially – but not fully – explains the negative impact of trading on performance.
- Conrad, Johnson, and Wahal (2001) document that soft-dollar trades have higher costs. We show that soft dollars are also associated with substantially higher levels of trading activity and a negative impact on fund performance.

While “portfolio turnover” has sometimes been suggested as appropriate for disclosure, NAPFA notes two fundamental problems with mere disclosure of portfolio turnover: (1) “portfolio turnover” is understated under the computation method adopted by the SEC; and (2) individual investors are seldom equipped with the knowledge necessary to

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understand the impact of portfolio turnover as an additional cost borne by the investor. Given that for domestic stock funds, the average turnover rate was approximately 94%, both as reported by Morningstar, Inc., on December 31, 2006, it is important that portfolio turnover rates be accurately presented and that portfolio turnover rates result in estimates of expenses, in percentage terms, which are ultimately borne by the investor.

It should further be noted that Morningstar is in the process of developing a method of estimating costs relating to portfolio turnover.

Absent actual computation of such costs by mutual funds themselves, using approved methodologies and employing capable consultants where proper, estimation of portfolio transaction costs by other methods should be utilized. Estimating costs is far more preferable than ignoring them.

The SEC has acknowledged the inadequacy of current disclosure of transaction costs. "Although transaction costs are taken into account in computing a fund's total return, they are not included in a fund's expense ratio because under generally accepted accounting principles they are either included as part of the cost basis of securities purchased or subtracted from the net proceeds of securities sold and ultimately are reflected as changes in the realized and unrealized gain or loss on portfolio securities in the fund's financial statements. As a result, current disclosure requirements focus on providing fund investors with information about two items that are related to transaction costs - portfolio turnover rate and dollar amount of brokerage commissions. All mutual funds (except money market funds) are required to disclose in their prospectuses the annual rate of portfolio turnover that they have incurred during the last five fiscal years. Investors can compare turnover rates to obtain an indication of how transaction costs are likely to vary among different funds. Funds (with the exception of money market funds) also must disclose in the Statement of Additional Information ("SAI") the actual dollar amount of brokerage commissions that they have paid during their three most recent fiscal years. The Commission is concerned that the current disclosure requirements do not directly address a fund's overall transaction costs or elicit sufficient information about these costs ... Although estimates of the magnitude of transaction cost and its components vary, the following estimates are representative. For the average stock fund, commission costs have been estimated at almost .30% of net assets (an amount equal to approximately 20% of the 1.42% expense ratio of the average long-term mutual fund in 2002); and spread costs have been estimated at approximately .45% of net assets (approximately 30% of the average expense ratio.) Market impact cost and opportunity cost are more difficult to measure. One study estimates that total transactions costs (including market impact and opportunity costs) for large capitalization equity transactions range from 0.18% to as much as 1% of the principal amount of the transaction. Another study estimates that for institutional investors, under relatively stable market conditions, opportunity costs may amount to 0.20% of value. To summarize, commissions are explicit costs, readily identifiable and quantifiable. Spread, impact, and opportunity costs are implicit costs. Because the

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implicit costs, which are difficult to identify and quantify, can greatly exceed the explicit costs, there is no generally agreed-upon method to calculate securities transaction costs." Concept Release, "Request for Comments on Measures to Improve Disclosure of Mutual Fund Transaction Costs," SEC Release Nos. 33-8349; 34-48952; IC-26313; File No. S7-29-03 (Dec. 18, 2003).