June 15, 2007

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

Re: File Number 4-538 SEC Request for Public Comments Regarding 12b-1 Reform

Dear Ms. Morris:

To begin, we would like to express our sincere appreciation to the SEC for allowing this period of public commentary in advance of the June 19th round table discussion pertaining to the history and future of Rule 12b-1. That said, before providing feedback on the round table discussion agenda, we are compelled to express our concern that the forum appears to be stilted in favor of either repeal or dramatic reform. This concern arises from recent public statements from Chairman Cox and Investment Management Division Director Andrew Donohue (see text of March 26, 2007 speech) that appear to call for the repeal of Rule 12b-1, and from the fact that the round table discussion panels appear to overly weighted with individuals and organizations that have historically been publicly and vocally critical of 12b-1 fees. Further troubling is the inclusion of certain panelists, including Morningstar's Don Phillips (see Morningstar's 4-19-07 self-published article entitled "***Memo to SEC: 12b-1 fees must go***"), no load fund executive/nationally syndicated DIY investor advice columnist, Melody Hobson, and Motley Fool analyst, Shannon Zimmerman, all of whom represent organizations that cater to the do-it-yourself investor market and whose companies stand to gain financially from Rule 12b-1 reform or repeal. Although we do not necessarily oppose the inclusion of these organizations in the debate, it is worth noting that the Financial Planning Association (FPA) and the financial advisor community in general appear to have been entirely excluded from the round table discussion. A review of the public commentary submitted to date indicates that the financial advisor community has strong opinions on this subject, and their omission from the round table panels seriously detracts from the balance and fairness of the debate.

With respect to the round table agenda, it is our hope that the panelists discussing the historical perspective of Rule 12b-1 (Panel #1) will dispel the widely held misconception that Rule 12b-1 was enacted to help the mutual fund industry at a time when it was experiencing fund outflows and that its sole aim was to reduce investor expenses by helping mutual funds achieve economies of scale. A review of the historical record reveals that the mutual fund outflows that occurred following the bear market of the mid 1970s had long been reversed by the time Rule 12b-1 was enacted in 1980. Although it is true that the SEC envisioned operating expense reduction as a result of economies of scale as one potential desirable outcome from enacting 12b-1, it is also documented in the SEC's administrative records that the adopting language of Rule 12b-1 was intentionally left vague to allow for the possibility of other innovative applications that might benefit investors through increased competition and/or increased fund selection.

In terms of the evolution of the applications of Rule 12b-1, critics contend that it failed in achieving the goal of lowering investor expenses through achieving economies of scale and that current applications of 12b-1 are inconsistent with the SEC's original intent. While it is true that, on average, operating expense ratios have not fallen appreciably since 1980, one point that is often overlooked is that the rule was specifically enacted to give a competitive boost to the no-load industry. In this regard, the SEC was undeniably successful, as the number no-load funds expanded exponentially following the rule's inception. Do it yourself investors may not have benefited from significant declines in operating expenses, but the profusion of no-load fund options certainly saved that segment of the population countless millions of dollars in sales charge expenses by giving them an alternative to purchasing mutual funds through full service brokerage firms. Further, it can be argued that the enactment of Rule 12b-1 also facilitated the proliferation of low expense index funds. Today, retail investors have dozens of index fund choices with expense ratios that are indeed considerably lower than what was available in 1980.

As for the alternative applications of 12b-1 fee that developed since 1980, it is true that only a small fraction (2%) of total 12b-1 fees paid by fund companies today are used to pay for marketing and advertising. However, the administrative record shows that the SEC anticipated future innovations in the application of the rule and favored such changes in the interest of fostering competition and broadening investor choice. The competitive advantage that the adoption of 12b-1 gave to the no-load fund industry was nothing short of astounding, as the no-load segment of the fund industry grew to nearly 50% market share in the ensuing decade. This market share gain was, in part, enabled by the creation of discount brokerage firm “fund supermarket” platforms. The payment of 12b-1 fees by no-load fund companies to discount brokerage firms for inclusion in these platforms represented one of the first perversions of the original application of 12b-1 fees, and it offered an obvious benefit to self-directing investors by enabling them to consolidate their no-load mutual funds with a single custodian on a single statement.

The tremendous competitive threat the no-load fund companies represented to advisor-distributed fund companies did not go unnoticed. In response, advisor-distributed fund companies argued that full-service investors were increasingly reluctant to pay up front sales charges and were demanding alternative means of paying for funds through financial advisors. The SEC, in the interest of increasing investor choice, was swayed by this argument and began approving the payment of 12b-1 fees to full service brokerage firms. Through the more than 300 exemptive orders approving 12b-1 fees to be used in this fashion, the SEC actively oversaw and participated in the introduction of the various mutual fund share classes. In 1995, the SEC formally permitted this application of 12b-1 fees through the passage of Rule 18f-3. Coincident with this was the introduction of the innovative Class C or “level-load” share class structure, which typically pays the distributing brokerage firms an ongoing 1% 12b-1 service fee. At the time they were first introduced, this share class was lauded because it gave investors a way to purchase mutual funds through a full-service advisor in a manner that aligned the advisor-client interests more effectively than the commission-based Class A & B share classes. Again, this innovation, which arose as a result of competition originally sparked by the enactment of Rule 12b-1, brought a clear benefit to investors. Thus, a review of the history of Rule 12b-1 leads to the following conclusions:

(1) The SEC intended for the applications Rule 12b-1 to evolve over time.
(2) Rule 12b-1 was wildly successful in fostering competition and in giving retail investors low cost alternatives.
(3) The SEC was actively involved in approving each new application of 12b-1 fees along the way.
(4) It can be demonstrative that most of the innovative applications of 12b-1 fees that have developed since 1980 provide clear, specific benefits to investors.

Another panel of the round table forum (Panel #4) seeks to consider the potential impact and effects the the repeal of Rule 12b-1 on investors and the marketplace. Since the lion’s share of 12b-1 fees today are paid to full service brokerage firms, it stands to reason that the investor group most affected would be retail investors who have chosen to purchase mutual funds with the assistance of a financial advisor. As described in a number of the public comments that have been submitted to the SEC, most financial advisors believe that the impact will be overwhelmingly negative on their clients. Specifically, advisors predict that investors with smaller accounts will be abandoned and forced to self direct, while more affluent investors will likely be encouraged to migrate to more costly investment advisory wrap accounts. The notion that this group of investors, most of whom are willing to pay for the services of a financial advisor, will applaud the elimination of 12b-1 fees seems extremely misguided. Further, it could also be argued that the elimination of 12b-1 fees might be harmful to no-load fund investors if the elimination of12b-1 fees leads to a disincentive for discount brokerage firms to include certain mutual funds in their service platforms.

While it is obvious that full service brokerage firms and financial advisors stand to lose the most from the elimination of 12b-1 fees, as referenced at the beginning of this letter, it should be recognized that certain organizations that cater to investors who self-direct their investments stand to gain significant revenue from the virtual elimination of their full-service competitors. Such beneficiaries of the repeal of Rule 12b-1 might include the large no-load fund complexes, mutual fund research and ratings services, and certain financial publications (both online and print media) that cater to the DIY market.

Panel #4 also seeks to consider reform options. To this end, it should be noted that the NASD sponsored a year long study into this issue through the formation of a 20 member task force comprised of leading industry executives on both sides of the debate. The Mutual Fund Task force, which was sanctioned by the SEC, concluded in its 2005 Final Report that the SEC should NOT repeal 12b-1, but that the emphasis should instead be on improving fee disclosure. Intuitively, improved disclosure would appear to be a far simpler and less disruptive solution than either eliminating 12b-1 fees or forcing them to paid at the account level instead of the fund level.

In conclusion, while it is fair and reasonable to review the current relevance and investor benefits of various applications of 12b-1 fees, it should be obvious to the objective observer that the repeal of 12b-1 has the potential to cause great harm to thousands of individual investors who purchased mutual funds through the retail brokerage channel. It should also be recognized that such a dramatic change has the potential to be disruptive to the stock market as a whole as it would likely significantly disrupt competition between full-service and no-load mutual fund companies and perhaps cause demand for mutual funds in general to fall.

Thank you again for the opportunity to contribute to this discussion.

Yours truly,

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