



**NATIONAL ASSOCIATION OF  
INSURANCE AND FINANCIAL ADVISORS**

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2901 Telestar Court  
PO Box 12012  
Falls Church, VA  
22042-1205  
www.naifa.org

703/770-8100

Capitol Hill Office:  
512 C Street, NE  
Washington, DC 20002

November 5, 2010

Elizabeth M. Murphy  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, D.C. 20549-1090

**Re:** Proposed Rule Regarding Mutual Fund Distribution Fees and Confirmations

**FILE NO.** S7-15-10

Dear Ms. Murphy:

This letter will present the views of the National Association of Insurance and Financial Advisors (“NAIFA”) in response to the Securities and Exchange Commission’s (“SEC” or the “Commission”) invitation to submit comments on the proposed new rule and rule amendments that would replace rule 12b-1 under the Investment Company Act (“proposed rule” or the “Proposal”).

**Introduction**

NAIFA comprises more than 700 state and local associations representing the interests of 200,000 members and their associates nationwide. NAIFA members focus their practices on one or more of the following: life insurance and annuities, health insurance and employee benefits, multiline, and financial advising and investments. Founded in 1890 as the National Association of Life Underwriters, NAIFA is the nation’s largest financial services membership association. The vision of NAIFA is to protect and promote the critical role of insurance in a sound financial plan and the essential role provided by professional agents and advisors.

NAIFA's mission is to advocate for a positive legislative and regulatory environment, enhance business and professional skills, and promote the ethical conduct of our members who assist the public in achieving financial security and independence. Approximately 80 percent of all NAIFA members are licensed as Registered Representatives of broker-dealers and market and service mutual funds, and a representative percentage are Investment Adviser Representatives.

NAIFA and its members take great interest in the SEC's Proposal to replace rule 12b-1. The investors the SEC is seeking to protect with the proposed rule are the same people that NAIFA members serve every day: lower and middle-market investors with thousands (not millions) of dollars to invest, who rely on the honest, trustworthy guidance of their financial advisor to help manage risk and plan for retirement. Without such personalized advice from financial professionals who have earned their trust over many years of service, these investors would be forced to utilize, at best, impersonal, "one size fits all" advice from brokerage firms that do not tailor recommendations or advice to the specific needs of individual clients. NAIFA members, on the other hand, develop and maintain long-term relationships of trust with their clients. As small business owners, NAIFA members are Middle America and serve Middle America. Because they must take the time to get to know and understand their clients' personal and financial goals, our members are able to offer a service middle-market investors truly value.

NAIFA strongly supports the SEC's efforts to protect investors, and agrees with many components of the SEC's proposed rule. In particular, retaining the annual 25 basis point asset-based fee under new rule 12b-2 will help registered representatives to continue to provide ongoing service and advice to their clients, an important benefit to investors. These fees are legitimate, earned compensation for providing valuable services which greatly benefit individual investors. In exchange for a small annual payment, investors have access to a financial services expert to answer their questions and address their concerns. Without their advisor, investors would have nowhere to turn (except for perhaps a stranger at the end of a 1-800 phone number) when they needed reassurance in a shaky market, assistance in rebalancing their portfolios, or understanding the investment choices available. If these ongoing service fees were eliminated, advisors would be forced to charge their clients fees based on either an hourly rate or assets-under-management as compensation for the time spent servicing their

clients' needs. The net effect is that while the client might initially save a small amount from the elimination of these fees, he or she would end up paying a much larger amount in hourly or assets-under-management based fees to receive the same service.

Although we support proposed rule 12b-2 and other provisions of the proposal, we have several concerns regarding the unintended consequences that other provisions of the Proposal might cause. Primarily, we believe the Commission's efforts to facilitate retail price competition by permitting mutual funds to issue new share classes at net asset value and allowing broker-dealers to determine their own sales compensation on these share classes will limit the ability of financial professionals to offer the personalized, individually tailored investment advice that many middle-market investors expect and deserve. In an effort to gain market share, broker-dealers will inevitably use this provision to offer fund shares with commissions and sales charges that are so low that personalized financial advice will no longer be concomitant with the purchase of the shares. In much the same way that the rebating of insurance policy sales commissions was identified as a problem practice by most state insurance regulators, this "race to the bottom" will cause lower and middle market investors to be overly focused on price, and to not recognize the value and advantages personalized service affords them. In other words, in effectuating its desire to level the playing field and lower costs, the SEC's Proposal would eradicate the market for personalized investment advice for lower and middle market investors.

In the comments that follow, we provide a brief overview of the markets that NAIFA members work with and the valuable services they provide their clients, followed by a further discussion of the adverse impact some components of the Proposal will have on lower and middle market investors.

### **Overview of NAIFA Members and the Regulations That Govern Them**

NAIFA members are financial professionals who primarily serve the lower and middle-markets. Our members help their clients address the wide spectrum of long-term financial needs faced by individuals and families by recommending financial products that are appropriate for their clients' unique circumstances. The scope of their services are focused on the individual needs of every client,

taking into consideration the client's goals and situation, including anticipated retirement plans, job security and income, and employee benefits.

Under current law, NAIFA members who are registered representatives of a broker-dealer have an obligation to recommend only those approved specific investments and overall investment strategies that are suitable for their clients. Unless our members have an adequate and reasonable basis for making a recommendation, they are legally precluded from doing so. Additionally, NAIFA members are obligated to determine "customer-specific" suitability, taking into account every client's particular financial situation, needs, and other security holdings. Thus, in order to fulfill their legal and ethical obligations, NAIFA members must spend a great deal of time getting to know their clients, regardless of whether those clients are wealthy institutions or lower-income members of their community. All NAIFA members share the belief that every American deserves first class, personalized advice on how to manage their finances in a smart, responsible manner that affords them financial independence.

### **Comments on the SEC's Proposed Rule Regarding Mutual Fund Distribution Fees and Confirmations**

As indicated above, we share the SEC's desire to protect middle-market investors. Moreover, we believe many portions of the Proposal accomplish this end. For example, as discussed above we share your belief that the "marketing and service fee" of up to 0.25% deducted annually from fund assets to pay for distribution and investor servicing activities is a crucial component of mutual fund sales. The existence of these marketing and service fees helps facilitate our members' ability to provide personal service to their clients. Thus, we are pleased that the Commission's proposed Rule 12b-2 will maintain the status quo with respect to these fees.

In an effort to work with the SEC to better achieve what we view as mutually compatible goals, however, our comments below discuss two components of the proposed rule that will likely have unintended and detrimental consequences: (1) facilitating retail price competition by allowing broker-dealers to determine their own sales compensation; and (2) tailoring disclosure rules in such a manner

that investors get an incomplete and inaccurate picture of the fees and expenses mutual fund shares entail.

### **Facilitating Retail Price Competition**

The SEC's Proposal would permit a fund in certain circumstances to offer its shares or a class of its shares at a price other than the offering price stated in the prospectus. It would accomplish this by amending SEC Rule 6c-10 and granting an exemption from Section 22(d) of the Investment Company Act of 1940 to allow funds to sell shares at net asset value through broker-dealers who would be free to establish and collect their own commissions or other types of sales charges to pay for distribution. The Commission believes this would be a win-win for investors: the resulting competition among broker-dealers would place downward pressure on sales charges, and lead to tiered share classes offering different levels of service, so investors will have access to a greater variety of advisory services than they have today, albeit at a lower price.

Despite the Commission's intentions, however, the SEC fails to consider the incentives its proposal will create for both financial advisors and investors. Allowing broker-dealers to determine their own sales charges is as likely to lead to a diminution in services provided as it is to a decrease in costs charged. As noted above, in an attempt to build market share, broker-dealers will inevitably take advantage of this newfound freedom to determine their own sales charges by offering classes of shares at prices that are so low that personal financial advice will cease to be included with the purchase of fund shares. Those classes of fund shares that continue to include individually tailored financial advice will cost more, and thus dissuade less affluent, unsophisticated investors—those most in need of personal financial guidance but least able to afford it—from purchasing them.

Moreover, it is clear that the resulting competition among broker-dealers to keep share prices low will lead to financial intermediaries, such as NAIFA members, having to provide the same services they offer today for substantially less compensation. In addition, while the classes of shares that include personal financial advice will cost more than those classes that do not, broker-dealers will surely try to

undercut one another's prices as to *all* classes of shares. While some altruistic financial advisors may continue to service lower-income clients, as they do today, this "race to the bottom" will create a situation where it is no longer financially feasible for advisors to continue to provide the level of individual advice and ongoing service they currently provide to their lower and middle market clients. As a result, many experienced financial advisors with middle-to-low income clients will have no choice but to exit that market and take on wealthier clients that are willing and able to pay extra for a class of fund shares that includes personalized investment advice. This phenomenon could also cause advisors to leave the profession entirely, and discourage entry-level financial advisors from entering the market to begin with, as these representatives tend to advise less affluent clients at the beginning stages of their careers. The resulting dearth of financial professionals willing to advise middle-market investors will deprive many such investors of sufficient financial guidance – guidance they need and guidance they deserve.

This all-but-certain result will force investors with smaller fund account balances to self-direct if they wish to continue to own mutual funds, as their advisors will not be able to afford to spend the time to guide and advise them. Alternatively, such investors could utilize discount brokerage fund platforms, a perfectly legitimate option provided it is an *option* and not the *only* course of action at their disposal. Under current rules, many cost-conscious investors utilize discount brokerage fund platforms, and through them have access to thousands of no-load mutual funds; those wishing to receive more individually tailored advice are generally able to afford it from our members in all fifty states. We fear that the SEC's proposed rule, designed to protect investors, will instead result in discount brokerage platforms being the only affordable option for less affluent investors.

### **Enhancing Disclosure of Fees for Investors**

The Proposal aims to improve the transparency of distribution and marketing fees by abandoning the use of the term "12b-1 fees" in fund materials and replacing it with the terms "ongoing sales charge" and "marketing and services fees." We understand the Commission's concern that distribution costs are

not well understood by investors, and share its desire to provide investors a more complete picture of all the fees that purchasing mutual fund shares entails. NAIFA supports this part of the Proposal.

NAIFA is concerned, however, that under the SEC's Proposal investors might end up with a skewed picture of mutual fund fees. The revisions to Form N-1A will cause investors to notice those fees that support services provided by financial intermediaries (*i.e.*, the up to 0.75% asset-based sales charge permitted under proposed rule 6c-10 and the up to 0.25% marketing and service fee under proposed rule 12b-2), while doing nothing to enhance disclosure for other fees associated with purchasing mutual fund shares. Indeed, a great deal of fund expenses, such as custodial expenses, legal expenses, accounting expenses, transfer agent expenses, and certain shareholder service expenses, would be grouped together under the unspecific "other expenses category."

Thus, the Proposal will lead investors to have the mistaken impression that financial intermediaries benefit from a substantial portion of the overall fees that go into purchasing mutual fund shares. This alone is problematic, but is *especially* troublesome when viewed in light of the "race to the bottom" that will result from granting broker-dealers authority to determine their own sales charges. Indeed, the chances a middle-market investor will avail himself of the ongoing, personalized services of a financial intermediary are slim when (a) there are cheaper classes of shares that don't include such services, and (b) the fees disclosed in the prospectus misleadingly imply that intermediaries are responsible for a larger portion of the cost of fund shares than is in fact the case. NAIFA supports transparency and clarity in mutual fund disclosures. However, we urge the SEC to make certain that these disclosures are comprehensive and do not give a slanted view that unintentionally highlights only one aspect of mutual fund fees and expenses.

## **Conclusion**

As noted at the outset, we share the SEC's desire to protect middle-market investors. Indeed, these are the very investors responsible for the livelihood of many NAIFA members. With this desire, however, comes a responsibility to ensure that all investors, no matter their wealth or level of

sophistication, have access to affordable, personal, ongoing financial advice. Although there are portions of the SEC's proposal that further this end, the provisions discussed above—allowing broker-dealers to determine their own sales charges, and the incomplete and potentially misleading disclosure reforms—hinder it. We urge the SEC to take our comments into consideration as it implements a final rule, so that NAIFA members may continue to serve the investors the Commission seeks to protect.

Sincerely,

/s/ Gary A. Sanders

Gary A. Sanders

Vice President

Securities and State Government Relations