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November 5, 2010

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

Via Electronic Submission

RE: Comments on Mutual Fund Distribution Fees; Confirmations
Release Nos. 33-9128; 34-62544
File No. S7-15-10

Dear Secretary Murphy:

The North American Securities Administrators Association, Inc. (“NASAA”)¹ appreciates the opportunity to comment on Release Nos. 33-9128; 34-62544, File No. S7-15-1, “Mutual Fund Distribution Fees; Confirmations” (“Release”).² NASAA believes that transparency in both the amount of mutual fund fees, and the use of mutual fund fees, is critical to empowering investors to make an informed choice between the myriad available mutual funds.

Background

More than 87 million Americans own mutual funds. *Release* at 6. Although some investors might purchase mutual fund shares directly from the mutual fund sponsor, most investors purchase their shares through, and pay a sales charge or service fee to, an intermediary. *Id.* Under the Investment Company Act of 1940 (“Investment Company Act”), rule 12b-1 has allowed mutual fund companies to collect fees³ in the amount of \$9.5 billion in 2009. *Id.* at 24. As the Securities and Exchange Commission (“SEC”) observed in the Release, the rules governing sales charge arrangements “no longer fully reflect the current economic realities of the mutual fund marketplace or best serve the

¹ NASAA is the association of the 67 state, provincial, and territorial securities regulatory agencies of the United States, Canada, and Mexico. NASAA serves as the forum for these regulators to work with each other in an effort to protect investors at the grassroots level and to promote fair and open capital markets.

² Available at <http://www.sec.gov/rules/proposed/2010/33-9128.pdf>.

³ 12b-1 fees are an ongoing sales charge that a mutual fund pays, out of mutual fund assets, to an intermediary on behalf of the mutual fund investors. *Release* at 7.

interests of fund investors.” *Id.* at 8. As a result, the SEC is proposing to rescind, in its entirety, rule 12b-1 of the Investment Company Act, and is proposing a new rule and rule amendments.

Comments

- Rescission of Rule 12b-1

NASAA applauds the SEC for rescinding rule 12b-1. As we stated in our May 10, 2004, comment letter to the SEC (Release No. IC-26356, Prohibition on the Use of Brokerage Commissions to Finance Distribution) (“May 10, 2004 NASAA Comment Letter”), “Rule 12b-1 should be rescinded as it has outlived its original purpose ... as a means for start-up funds to expense marketing costs equally among fund shareholders [.]”⁴ Then, as now, the opaque nature of 12b-1 fees is the problem. “Investors do not know what they are being charged, nor do they know what exactly the charges are for.” *May 10, 2004 NASAA Comment Letter.*

Rescinding rule 12b-1 is an important first step in shifting mutual fund marketing costs away from investors and to fund managers. However, NASAA is concerned that the proposed rules and amendments do not go far enough to shift these costs. NASAA believes that the fund managers, and the board of directors of the mutual funds, should reduce mutual fund costs to investors.

- Proposed Rule 12b-2, the “Marketing and Service Fee”

NASAA believes proposed rule 12b-2, just like current rule 12b-1, will become a mechanism for allowing mutual fund managers to take advantage of investors. The new regulatory framework under proposed rule 12b-2 would permit mutual funds to deduct up to 25 basis points annually from mutual fund assets to pay for distribution activities (“Marketing and Service Fee”). *Release* at 41. The Marketing and Service Fee could be used to pay for the ongoing cost of the mutual fund’s participation in a mutual fund super market, trailing commission to broker-dealers, call center expenses, costs of printing and mailing prospectuses to prospective shareholders. *Id.* at 43. Calling the rule 12b-2 fee a “Marketing and Service Fee” does not change the fee’s essential makeup. The Marketing and Service Fee deducts money from mutual fund assets, and therefore deducts mutual fund returns from investors. In proposed rule 12b-2, the marketing costs are, once again, shifted away from the fund managers and investors are stuck paying for ordinary business expenses that should be assumed by the mutual fund manager.

4 Available at <http://www.sec.gov/rules/proposed/s70904/nasaa051004.pdf>.

- Proposed Amendments to Rule 6c-10, the “Ongoing Sales Charge”

The proposed amendments to rule 6c-10 would permit mutual funds “to deduct asset-based distribution fees *in excess of* the amount permitted under [proposed rule 12b-2.” *Release* at 46. These excess fees would be considered an “Ongoing Sales Charge,” and would be subject to a maximum sales charge restriction and an automatic conversion feature. *Id.* The proposed amendments to the rule would treat the Ongoing Sales Charge as a deferred sales load. *Id.* at 47. The automatic conversion feature would satisfy the maximum sales charge limitation by automatically converting mutual fund shares to another class of shares without an Ongoing Sales Charge. NASAA believes that the proposed sales charge limitations in the Ongoing Sales Charge do not adequately protect investors from excessive sales loads. For example, once an investor has reached the Ongoing Sales Charge limit, an unscrupulous broker-dealer could recommend switching⁵ between fund families thereby continuing the stream of payments to the broker-dealer. The unwitting investor would be once again plunged into paying the Ongoing Sales Charge (along with the Marketing and Service Fee).

- Amendments to Improve Disclosure to Investors

As a long-standing advocate of providing investors with all relevant information prior to their investment decisions, NASAA believes that the full disclosure of mutual fund fees is a critical tool to help investors make the right investing decision. NASAA supports the SEC’s efforts to provide more disclosure to investors and supports measures that create greater transparency of mutual fund fees and expenses; the proposed rule amendments, however, do not go far enough in that direction.

The proposed rule amendments would revise several disclosure requirements in Form N-1A.⁶ *Release* at 98. Item 3 of Form N-1A would be amended to replace the current line item reference to 12b-1 fees in the fee table with “Ongoing Sales Charge,” and a new “Marketing and Service Fee” sub-heading would be added to the “Other Expenses” category. *Id.* at 99. A fee table, though, may not be the best way to make fee disclosures to investors. As NASAA previously stated in its March 5, 2004, Comment Letter to the SEC (Release Nos. 33-8349, 34-48952 Measures to Improve Disclosure on Mutual Fund transaction Costs) (“March 2004 NASAA Comment Letter”),

[] A plain-English summary document provided at the time of sale, prominently displaying uniform industry information regarding expenses and sales loads would attract the attention of the investor and allow

⁵ “Mutual fund switching violates the antifraud provisions of the federal securities laws when registered representatives, in order to increase their compensation, induce investors to incur the costs associated with redeeming shares of one mutual fund and purchasing the shares of another fund and the benefit to the customer does not justify those costs.” See *Russell L. Irish*, 42 S.E.C. 735, 736-40 (1965), *aff’d*, *Irish v. SEC*, 367 F.2d 637 (9th Cir. 1966), *cert. denied*, 386 U.S. 911 (1967).

⁶ Form N-1A6 is the registration form used by mutual funds to register with the SEC.

investors to make an informed decision. NASAA would prefer the document to be standardized, provide peer information on expenses identifying what an average similar fund in the same category would charge. Such information should be provided in both the prospectus and statement of additional information. Simple and quantifiable information which all funds display prominently in a comparable format will be valuable for investors in evaluating, comparing, and making investments.⁷

NASAA still believes that a standardized, plain-English, summary document of mutual fund fees provided to investors at the time of the mutual fund sale is critical to help investors make the right investing decision.

Conclusion

In conclusion, while we commend the SEC for taking steps to strengthen investor protection relating to mutual fund fee disclosures, NASAA believes the amendments to the rules do not go far enough, and thus remain open to industry abuse and investor confusion.

Thank you again for the opportunity to comment on the Release. Should you have any questions regarding these comments, please contact the undersigned or Tina Stavrou, NASAA's Assistant General Counsel, at ts@nasaa.org.

Sincerely,

/s/ A. Heath Abshure

A. Heath Abshure
Arkansas Securities Commissioner, and
Chair, NASAA Corporation Finance Section

⁷ Available at http://www.nasaa.org/content/Files/Mut_Fund_Costs.38049-35723.pdf.