

12b1transcript

1	PARTICIPANTS:	
2		
3	Brad M. Barber	Avi Nachmany
4	Martin G. Byrne	Charles Nelson
5	Matthew P. Fink	Don Phillips
6	Andrew J. Donohue	Richard M. Phillips
7	Mark R. Fetting	Robert E. Plaze
8	Joel H. Goldberg	Barbara Roper
9	Richard W. Grant	Joseph R. Russo
10	Paul G. Haaga, Jr.	Douglas J. Scheidt
11	John A. Hill	Thomas M. Selman
12	Melody Hobson	Michael J. Sharp
13	Jeffrey C. Keil	Erik R. Sirri
14	Kathryn Bradley McGrath	Robert W. Uek
15	John R. Morris	Shannon Zimmerman
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1 P R O C E E D I N G S

2 CHAIRMAN COX: Welcome to the Securities and
3 Exchange Commission Roundtable on Rule 12b-1, under the
4 Investment Company Act.

5 To many of you who are seated here, or who are
6 listening on the Internet today, Rule 12b-1 has a special

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7 meaning, and a long history, as least as far as mutual fund
8 regulation is concerned. To others, Rule 12b-1 is merely an
9 obscure reference to one item in a thick book of rules.

10 But for the millions of Americans who invest their
11 savings in mutual funds, Rule 12b-1 is important. If you
12 don't appreciate the rule number, you surely will appreciate
13 the dollar amount.

14 Rule 12b-1 allows mutual funds to spend nearly \$12
15 billion a year in investors assets, to reimburse expenses,
16 such as the marketing of mutual funds to other investors and
17 administrative services. The Commission originally adopted
18 Rule 12b-1 in 1980. At that time, the Commission noted in
19 our adopting release that we and our staff would monitor the
20 rule's operation closely.

21 And if experience suggested the rule's restriction
22 on the use of fund assets weren't strict enough, we would be
23 prepared to act to remedy the situation.

24 Now, with nearly three decades of experience under
25 our belt, it's time that we take serious steps to re-evaluate

1 the rule. Today, we have gathered an impressive group of
2 panelists to help us take a fresh look at Rule 12b-1. I
3 expect that they will express a wide range of views on the
4 history and on the future of the rule.

5 Today's discussions will help to inform the
6 Commission, as it determines the next steps it will take,
7 later this year. The roundtable is going to consist of four
8 panels.

9 The first panel will discuss the history of Rule
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10 12b-1. What were the circumstances that led the Commission
11 to adopt it back in 1980? What was the original purpose of
12 the rule, and how did the use of the rule evolve and change
13 over the intervening years? We will hear from individuals
14 who were intimately familiar with all of these developments.

15 The second panel will discuss the ways that mutual
16 funds, their investment advisers, and broker dealers
17 currently use Rule 12b-1. We will hear about these modern
18 business practices from a distinguished group that includes
19 representatives of mutual fund firms, broker dealers, and the
20 NASD.

21 After the lunch break, the third panel will discuss
22 the costs and benefits of Rule 12b-1. Sometimes we think of
23 cost benefit analysis as applying to new rules and
24 amendments. But it also applies to rules that have been on
25 the books for years. On this panel, we will hear from

1 experts who can speak to the economic effects of Rule 12b-1,
2 from an academic, as well as a business perspective.

3 Finally, the fourth panel will discuss the various
4 options the Commission will have, going forward. The
5 panelists will consider a number of cutting edge questions.
6 Should 12b-1 be rescinded? Should it be revised, or revised
7 only on the margin? Should the money that broker dealers
8 receive come not from fund assets, but directly from
9 investors, out of their brokerage or mutual fund accounts?
10 Is there a different way to disclose these payments to
11 investors, that is more understandable? On this panel, we
12 will hear from those who have thoroughly analyzed these

13 issues, with regard to mutual funds, broker dealers, and
14 investors.

15 On behalf of the Commission and our staff, I would
16 like to thank our panelists who have devoted the time and the
17 energy that I know that you have invested in order to be
18 here, and help us grapple with these issues.

19 I look forward, as do all the commissioners, to
20 your insights at today's roundtable, as we go forward in this
21 important area.

22 With that in mind, I would like now to turn it over
23 to Doug, who will help us moderate this panel, and to Buddy
24 Donohue, the director of the investment division, for his
25 opening remarks.

1 MR. DONOHUE: Thank you, Chairman Cox. Thank you
2 all for being here today, at our roundtable on 12b-1. Before
3 I begin, I need to note that the views expressed by me, and
4 all SEC moderators throughout the day, are our own, and do
5 not necessarily reflect the views of the Commission, or our
6 colleagues on the staff at the Commission.

7 In fact, as moderators, we may at times ask
8 questions or make statements that do not necessarily reflect
9 our personal views, but are, instead, designed to elicit an
10 insightful dialogue. We hope these questions will contribute
11 to a meaningful and constructive discussion regarding Rule
12 12b-1.

13 I am pleased to see the interest that Rule 12b-1
14 has generated among our panelists and audience members, and
15 those who are joining us by webcast from their homes and

16 offices. I have a personal interest in the rule, as well,
17 because I have lived with the rule throughout its existence.

18 When I began my career in 1975, mutual funds had
19 \$50 billion in assets under management. During that decade,
20 in 7 of 8 years between 1972 and 1979, funds experienced
21 significant net outflows. At the time, the Commission
22 generally prohibited funds using fund assets to pay for the
23 sale of its shares, out of concerns about the inherent
24 conflicts of interest in such arrangements.

25 In view of the market conditions of the time,

1 however, some petitioned the Commission to reverse its
2 long-standing position, and permit funds to use a small
3 portion of fund assets to pay for advertising and selling.

4 This, it was argued, would benefit shareholders,
5 because advertising and selling efforts would increase fund
6 assets, and increasing fund assets would have the effect of
7 decreasing fund expense ratios. And with a more stable asset
8 base, would enable fund managers to better manage their
9 portfolios.

10 Following hearings and several rounds of public
11 comment, the Commission concluded that there may be
12 circumstances under which it would be appropriate for a fund
13 to bear its distribution expenses. The Commission was
14 willing to test the notion that increased fund assets would
15 benefit shareholders by creating better economies at scale,
16 and a more stable asset base.

17 In addition, there was some recognition that small
18 12b-1 fees could subsidize the marketing and advertising

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19 expenses of the growing legion of no-load funds, and thereby
20 promote healthy competition between no-load funds and
21 broker-sold funds.

22 Thus, in 1980, the Commission adopted Rule 12b-1,
23 to permit funds to use fund assets to finance distribution,
24 subject to the control and supervision of fund directors.

25 Admittedly, this is not a very nuanced description

1 of events, but I shall leave it to the first panel to give us
2 the inside story on how and why 12b-1 was adopted. I raise
3 the subject, only to show that we have come a long way from
4 1980.

5 Today, it is hard to imagine a time when people
6 were concerned about net redemptions and mutual funds. Since
7 the Commission adopted Rule 12b-1 mutual funds experienced a
8 period of tremendous growth, with almost uninterrupted
9 increases in sales and assets. The industry is thriving.

10 As of the end of 2006, assets under management
11 exceeded \$10 trillion. Funds now serve as a primary
12 long-term investment vehicle for almost half of all
13 Americans, and account for almost a quarter of all financial
14 assets of U.S. households.

15 The use of 12b-1 has similarly experienced dramatic
16 growth during this period. Approximately two-thirds of all
17 mutual fund classes have adopted 12b-1 plans, and over 90
18 percent of load share classes have 12b-1 plans.

19 In the early 1980s, shareholders paid a few million
20 dollars in 12b-1 fees. In 2006, they paid almost \$12 billion
21 in 12b-1 fees. The use of 12b-1 fees also has shifted from

22 the limited marketing and advertising purposes that were
23 originally envisioned.

24 Now, the nearly \$12 billion that shareholders pay
25 annually in 12b-1 fees are used primarily as a substitute for

1 a sales load, or to compensate brokers for servicing their
2 clients, uses that are much different from what the
3 Commission originally intended when adopting the rule.

4 Although there is much room for debate on Rule
5 12b-1, which will be made abundantly clear today, most
6 observers agree that there is a disconnect between how the
7 rule is supposed to operate, and how it used today. As I have
8 said before, one would be hard-pressed to believe that Rule
9 12b-1 wouldn't benefit from at least a tune-up.

10 As Chairman Cox previously remarked, when the
11 Commission adopted Rule 12b-1, it noted that it would monitor
12 the operation of the rule, and be prepared to address the
13 rule if the circumstances or experience warranted. In view
14 of the changes in the mutual fund market, and the role of
15 12b-1 in fund distribution practices, the Commission is
16 re-examining the rule, to evaluate whether it continues to
17 benefit mutual fund shareholders, or whether it would profit
18 from re-consideration.

19 This roundtable is part of a deliberative process.
20 In putting together a roundtable, we made an effort -- and I
21 believe a successful one -- to bring together representatives
22 from a wide variety of interested groups, to share their
23 perspectives and insights on the issues that we are examining
24 today.

2 on historical circumstances that led to the adoption of
3 12b-1, the original intended purpose of the rule, and how the
4 use of the rule evolved over time.

5 The panelists today are a distinguished group. All
6 of them played an important role in the events leading up to
7 and including the adoption of Rule 12b-1, or the evolution of
8 Rule 12b-1 plans, thereafter.

9 In no particular order -- although it does work
10 from my far right to my left -- the first panelist, Matt
11 Fink. Matt Fink was a long-time representative of the
12 Investment Company Institute, which is the trade association
13 for the mutual fund industry. Matt served in various roles
14 for the ICI, including as its president. He currently serves
15 as a fund director.

16 Second panelist, Joel Goldberg. Joel served on the
17 staff of the division of investment management in the 1970s
18 and 1980s, and served as the director of the division in 1981
19 and 1982.

20 Dick Grant served as a special counsel to the
21 director of the division of investment management, and he
22 served as an associate director in the division in the late
23 1970s and early 1980s. He was a principal architect of Rule
24 12b-1.

25 And last, but by no means least, Kathie McGrath.

1 Kathie McGrath served as a division -- director of the
2 division of investment management from 1983 to 1988.

3 We will start our panel today with Joel Goldberg,
4 who will begin the discussion of the historical circumstances

5 that led to the adoption of 12b-1. And Joel will cover,
6 among other things, how the distribution of fund shares was
7 financed before Rule 12b-1, what the historical position of
8 the Commission was towards the use of fund assets for
9 distribution.

10 And so, Joel, take it away.

11 MR. GOLDBERG: Thank you, Doug. I would like to
12 start by disposing of one of the myths surrounding the
13 adoption of Rule 12b-1. The myth is that Rule 12b-1 was
14 adopted in response to concerns about net redemptions. In
15 fact, net redemptions had ceased long before Rule 12b-1 was
16 proposed or adopted. It had nothing to do with it.

17 There was a confluence of events that led the
18 Commission to reconsider its historic position that mutual
19 funds should not pay for distribution. The first of these
20 events, which received little public notice at the time, was
21 a no-action request from a company called Armstrong
22 Associates. It was a broker-dealer in Texas, had a no-load
23 fund, which had never reached economic size.

24 And Armstrong Associates came in for a no-action
25 letter, asking for permission to use half of their advisory

1 fee to pay broker-dealers what we would now call a trail.
2 They didn't call it that then, but pay half of their advisory
3 fees to broker-dealers to get them to sell shares of a
4 no-load fund, and keep shareholders invested.

5 The fund had been in existence for a number of
6 years. The advisory fee, although a little bit on the high
7 side, had not been increased, it was what it had always been.

8 The staff said, "Well, there is no basis for us to say that
9 they can't use half their advisory fee however they want;
10 it's their money." So the staff gave Armstrong the no-action
11 letter.

12 This was in 1976, before there was electronic
13 research. It was in its infancy then. And very few people
14 were aware of the Armstrong letter. It was a public letter,
15 but nobody heard about it.

16 About a year later, the sponsors of two newly
17 formed money market funds were casting about for ways to
18 incent broker-dealers to place customers' cash in their
19 funds. One of these funds, called "Mutual Liquid Assets,"
20 requested no action permission to give half of its advisory
21 fee to broker-dealers who sold shares of the funds. You
22 know, the staff obviously recognized the similarity to
23 Armstrong Associates. The only material difference was,
24 Mutual Liquid Assets was a newly formed fund. So you
25 couldn't be sure that the advisory fee would have been the

1 same if they weren't giving up half of it. But the fee was
2 in the range of what other money funds were charging at the
3 time, which was 50 points.

4 So, the staff gave Mutual Liquid Assets the
5 no-action letter. In those days, no-action letters remained
6 non-public for 30 days after being issued. So we had a brief
7 period of peace.

8 While we were in that quiet period, the staff was
9 processing a registration statement from another money market
10 fund called "Banner Ready Resources." It was sponsored by

20 I think the Commission had always been concerned,
21 rightly, that there was a conflict of interest. Clearly, the
22 promotion of sales is good for the investment adviser,
23 because the advisory fee is a percentage of assets, right?
24 The bigger the fund, the bigger the advisory fee.

25 If mutual funds were allowed to pay for

1 distribution, the Commission was concerned that the benefits
2 to shareholders would be questionable, at best. But there
3 would clearly be a benefit for the adviser.

4 And, of course, Rule 12b-1 didn't exist at that
5 time, so there were no requirements about directors approving
6 it, and all of that.

7 MR. SCHEIDT: So, what happened next?

8 MR. GRANT: I think I take my cue from that one.
9 The Commission, as Joel mentioned, did initiate a rule-making
10 process. It was an arduous one, and one that took a long
11 time. It was five releases over a period of four years.

12 As Joel mentioned, accompanying the withdrawal of
13 Mutual Liquid Assets, the Commission put out a release. It
14 was numbered 94-70 -- you can tell how long ago it was -- it
15 was October 4, 1976, announcing that hearings would be held
16 the next month, in November.

17 The issue was described as the appropriateness of
18 mutual funds bearing distribution expenses, directly or
19 indirectly, a concern that existed then, and has existed over
20 the intervening 30 years, and still exists.

21 And I see I'm about to sound a theme that's going
22 to get sounded over and over again, the specific examples of

23 the types of expenses that might be incurred that were listed
24 were advertising and compensation for dealers.

25 As background in this very brief release, the SEC

1 said that it had questioned the propriety of mutual funds
2 bearing distribution expenses, citing the statement of the
3 future of the securities markets, which was, I guess, issued
4 in 1972. As noted, the Commission withdrew the Mutual Liquid
5 Assets letter. The hearings were then held on five days in
6 November, and it was the following August before the
7 Commission was heard from again.

8 Another brief release -- the number is 99-15, the
9 date is August 31, of 1977, and the SEC briefly but clearly
10 said, "We haven't changed our position yet. We think that
11 any plans for mutual funds to use their own assets to finance
12 distribution would require a Commission order. And people
13 who proceed differently do so on their own risk," which I
14 thought was a fair warning to people, not to get ahead of the
15 Commission on this.

16 The SEC briefly characterized the views that had
17 been expressed at the hearings as divided between those who
18 thought there were circumstances under which fund
19 shareholders could benefit from sales of shares -- and this,
20 again, was focused not on whether the mutual fund business
21 was in trouble, because of net redemptions, although
22 certainly that had been a serious concern, it was on the
23 question of whether, on an ongoing basis, shareholders could
24 benefit from having their own assets spent on distribution.

25 But the SEC also noted that there were plenty of

1 people whose view was that selling shares primarily
2 benefitted management, that management had significant
3 conflicts of interests in making any recommendation about the
4 expenditure of fund assets, and that that would be a problem
5 in any rule-making that ensued.

6 So, the next step was in May of 1978, and it was
7 eloquently titled, "An Advance Notice of Proposed
8 Rule-Making." In other words, the Commission still wasn't
9 ready to move forward, wanted to hear more from the public on
10 basic concepts as to whether this would be an appropriate
11 thing to do, and if so, what sort of regulation ought there
12 to be.

13 The Commission did indicate that they would suggest
14 some alternatives in order to provide structure for the
15 comments. And I don't think I mentioned that was release
16 10-252, the date is May the 23rd.

17 The Commission elaborated a little bit on its view,
18 as to the general tenor of the comments that had been
19 received during the hearings. Problems had been noted about
20 the industry experiencing net redemptions for a significant
21 period of time, but there were also concerns about the small
22 size of many funds, as to whether they were large enough to
23 be viable on an ongoing basis, and a perception that there
24 was a growing resistance to paying high front-end loads.

25 And in those days, as Buddy pointed out, the

1 industry was still pretty small, and the choice was either a
2 no-load fund, with no special provision made for financing
3 the shares, distribution of the shares, or very high
4 front-end load.

5 There were assertions that, in addition to
6 addressing these kinds of problems, again, that there could
7 be benefits, on an ongoing basis, in the distribution effort,
8 because it was in the interest of funds to grow, to maintain
9 their size. There was a natural attrition of funds, because
10 in the absence of any selling, on average, the funds would be
11 gone in five years or so, because of steady patterns of
12 investor redemption that are pretty constant, even today.

13 The advance notice of proposed rule-making said
14 there were three objectives to any rule-making that would
15 follow. One was minimizing the inherent conflicts of
16 interest -- again, the management has a clear interest in
17 having the fund itself bear a part of the burden of selling
18 the shares.

19 There would be clearer interest in putting the
20 decision and the oversight of any such expenditures in the
21 hands of the directors, especially the independent directors,
22 and the shareholders.

23 And there would be an objective to ensure that all
24 shareholders -- including existing shareholders who had
25 already basically paid the admissions price to get into the

1 fund -- that everybody should be treated fairly.

2 The Commission indicated that it would proceed with
3 rule-making, and it did proceed with rule-making, under

4 section 12b of the 1940 Act, which is, of course, what they
5 ultimately did.

6 The Commission asked for comments about the types
7 of expenses that might be permitted. The examples that were
8 listed were cash payments to dealers, advertising, and
9 payment for prospectuses used with prospective investors, as
10 opposed to existing investors.

11 In connection with the notion of cash payments to
12 dealers, the Commission specifically asked whether there
13 should be a distinction between what they characterized as
14 transaction fees -- sales loads and similar expenses paid in
15 connection with the transaction -- and those transaction fees
16 and payments to third parties for distribution services,
17 particularly to dealers in fund shares.

18 I guess I'm going to be the third person on the
19 panel to emphasize this particular point -- and not that
20 that's a surprise; I think we all had it in mind -- a number
21 of people in a number of ways have questioned whether the
22 Commission anticipated or intended that payments to dealers
23 would become part of the framework of the cost of selling
24 fund shares. And the answer to that question is, absolutely.

25 The Commission understood that, the Commission

1 expected that. And as a person who lived with this
2 rule -- and, in fact, had designing such a rule in my job
3 description at one time -- I can tell you it was my main hope
4 that, if such a rule was done, its major benefit would be the
5 reduction -- and, in some cases, the elimination -- of
6 front-end sales loads.

7 The Commission also addressed the issue of indirect
8 use of fund assets, which again, continues to be a hard one
9 for people to get a hold on. It's particularly an ongoing
10 struggle for directors, because the Commission then, as it
11 does today, and always has, acknowledged that third parties
12 who would have an interest in the mutual fund's shares being
13 sold were entitled to use their own resources to fund that
14 distribution.

15 The problem would arise, however, if, in fact, that
16 party -- and the Commission usually spoke in terms of the
17 investment adviser using its assets to fund distribution,
18 because it was the investment advisers who were doing most of
19 the subsidization of the sale of fund shares, and it was the
20 advisers who were receiving the largest compensation from the
21 fund.

22 But it was only an example. And if the question
23 was related to any third party using its own resources for
24 distribution, where that party had received compensation from
25 the fund, the Commission said it would be important for the

1 board to satisfy itself that the fee was fair, and had been
2 set without making any allowance in the fee for the advisers'
3 expenditure for distribution. And that same theme was
4 sounded, I guess, in virtually all the releases thereafter,
5 although the wording changed over time, as the Commission
6 tried to clarify the intent.

7 It was over a year before a rule proposal appeared.
8 That was September 7, 1979, the release number is 108-62.
9 The Commission noted that there had been 50 comments on the

10 advance notice of proposed rule-making, 20 that were in favor
11 of the use of fund assets for distribution, and 30 that were
12 opposed.

13 I'm not going to go through -- and you will all be
14 grateful that I am not going to go through -- the comments in
15 any detail. Because, the fact of the matter is, they really
16 didn't form the basis of the Commission's rule-making. I
17 think it's fair to say that the staff of the division of
18 investment management thought that it was necessary to have a
19 fresh approach.

20 At that point, basically nothing had worked. In
21 fact, I think we could have gone even further back in history
22 to try to find efforts to deal with the issue of spending
23 fund assets on distribution.

24 MR. GOLDBERG: Dick, I would like to correct one
25 thing I said, if I could interrupt you for a moment.

1 MR. GRANT: That's never happened before, Joel.

2 MR. GOLDBERG: Matt Fink, not for the first time,
3 has pointed out that I said something incorrect. I said that
4 net redemptions had ended by 1976. In fact, he just gave me
5 a whole sheet of numbers here, showing that they continued
6 pretty much through 1980.

7 But I would still tell you that that had nothing to
8 do with any of the events, as far as I was concerned, leading
9 to 12b-1.

10 MR. GRANT: Well, I think that's a fair point. The
11 Commission actually observed, in the 1978 release, net
12 redemptions seemed to have ended. But it wasn't deterred, in

13 going down the road of addressing this issue.

14 I think that's further evidence that the resolution
15 the SEC was looking for was a permanent one to this issue.

16 MR. GOLDBERG: And isn't it really that when you
17 couple funds paying for distribution with the sort of
18 undeniable permissibility of the management paying for
19 distribution -- when the management gets its money, guess
20 where, from the fund -- it is really very difficult
21 to prevent mutual funds from paying for distribution. What
22 you can do is to regulate it.

23 MR. GRANT: Well, you know, I think you have to be
24 realistic. It costs money to sell things, and it doesn't
25 matter whether it's a can of beer or a mutual fund share.

1 There are going to be people involved in the process.

2 Today, there is wide availability of no-load funds,
3 and yet most people are still buying their shares outside of
4 retirement plans and the like by paying somebody who is a
5 salesman or an adviser, however you would like to
6 characterize it.

7 MR. FINK: You spared us reading the comment
8 letters, and I don't want to force the audience to listen to
9 these, but not only was it clear from the commentators, that
10 they expected to be paying dealers; a number of them said
11 they expected to get rid of front-end loads if and when a
12 rule was adopted, and go to continuous fees.

13 I actually came out of the retirement home and went
14 down to the Institute a couple of weeks ago, and read the 800
15 pages of the 1976 transcript. And this is IDS, the largest

16 fund group in 1976. It was the Fidelity, or the Vanguard of
17 the American funds at that time.

18 This is Hamer Budge, former SEC chairman, chairman
19 of the IDS board, "It is the judgement of the board of
20 directors, and of IDS, the management company, based upon its
21 long experience in selling financial products, that the sales
22 load charge investors at the time of purchase should be
23 eliminated. There appears to be no way of doing this, except
24 to have the investor pay for sales distribution during the
25 life of his investment, rather than paying an initial sales

1 load at the time of investment. It seemed to us that the
2 straightforward solution would be to impose a direct charge
3 on the funds assets to pay for these efforts."

4 The Institute also submitted a brilliant comment
5 letter by Matthew P. Fink, general counsel, which said, "We
6 can foresee funds electing to supplement existing sales loads
7 with the use of fund assets for distribution expenses. We
8 can just as easily foresee funds electing to decrease or
9 eliminate sales loads if fund assets are used for
10 distribution expenses."

11 So, these were -- as the rule was being -- people
12 were well aware it was going to be used to pay dealers, as
13 you said. And people also thought about one of the
14 options -- there were different options.

15 One was to supplement the load, like we have for A
16 shares today. We have a load plus a 25 trail. Or, B and C
17 shares, where there is no load, there is a continuous fee.
18 And at least people in the industry said, "If you adopt a

19 rule, that's what we plan to do."

20 MR. GRANT: Matt, I would like to say --

21 CHAIRMAN COX: I'm sorry, I wonder if I could just
22 interject at that point, because there had been a fair amount
23 of discussion just now about what was intended back in 1980.
24 And it may or may not matter, but I have a letter before me
25 here from ICI of May 2004, a comment letter on 12b-1. And

1 it's signed, not by a general counsel, Matthew P. Fink, but
2 by President Matthew P. Fink.

3 And it says, "Mutual fund distribution practices
4 have changed dramatically since Rule 12b-1 was adopted in
5 1980. Most notably, the predominant use of 12b-1 fees for
6 most of their history has been as a substitute for front-end
7 sales loads, and/or to pay for administrative and shareholder
8 services that benefit existing fund shareholders. Although
9 these uses were not anticipated when the rule was first
10 adopted."

11 MR. FINK: I have no recollection of that letter.

12 (Laughter.)

13 MR. FINK: That's the reason I retired, Mr.
14 Chairman.

15 CHAIRMAN COX: I think all of this history is
16 extremely useful. And, you know, in fairness to President
17 Fink -- at the time -- the point you're making in that letter
18 is that, intended or not, ICI and you believe that those uses
19 are completely consistent with the original purposes of the
20 rule. And I think what we're examining here, and what we're
21 bringing out, suggests that that may well be the case.

22 MR. FINK: Mr. Chairman, I might just say
23 this -- and I don't know if it's a full explanation -- I
24 think -- and we're about to get to it; I don't want to cut
25 into Kathie's time -- I think what we anticipated --

1 advertising, payment for prospectuses for non-shareholders,
2 payments to dealers, either supplementing or
3 replacing -- what we didn't foresee was the contingent
4 deferred sales loads, which let amounts be paid that were
5 equal to the front-end load.

6 I think that was the -- and that may have been, if
7 I had to justify -- which I don't have to any more -- but if
8 I had to, I think that's what surprised all of us. We're
9 going to get to that in a minute, but that was the
10 event -- it's now called B shares -- that at least Dave
11 Silver, who was president of the Institute, and I think other
12 people, were very surprised about.

13 MR. GOLDBERG: And, you know, what's interesting
14 about that, Matt, is we shouldn't have been surprised,
15 because the insurance industry had been using that method of
16 financing sales commissions for many years. They had
17 mortality and expense charges, and they would advance the
18 sales commission to the salesman, pay it back through the
19 M&E.

20 But I agree with you. Certainly no one on staff, I
21 think, ever thought --

22 MR. FINK: We also thought it wouldn't survive. I
23 remember the day -- I can't remember what I had for lunch
24 yesterday, but I can remember clearly, when we saw that, we

2 the amounts that could be spent on distribution to have a
3 rule follow a process calling for approval by the directors
4 and by the shareholders, at least in the case of a new plan
5 for an existing fund, all with the oversight of the
6 independent directors.

7 And, in fact, that process was designed to reflect,
8 or be very similar, to the process that funds have to go
9 through anyway, in the approval and annual renewal of
10 investment advisory agreements, and with agreements with the
11 principal underwriter, the idea being that all those
12 decisions can be considered, collectively.

13 The rule was put out by a three-to-two vote, the
14 chairman providing the third vote, and I think he was
15 basically really willing to hear what the public had to say.
16 And I think he might have voted the other way, had it not
17 been for the fact that he was the one who was promoting this
18 regulatory reform idea, in the first place.

19 The comment was hostile. I think that's really the
20 only word for it. And, Matt, I wanted to say that your
21 comment letters were frequently brilliant, and almost always
22 painful for the recipient. I remember them well.

23 But, ironically -- and I'm only half facetious when
24 I say this -- I think the two commissioners who were most
25 reluctant were persuaded. One of them said, although with a

1 smile, that, "Well, if they hate it that much it can't be as
2 bad as I thought it was."

3 So, the Commission maintained the basic structure
4 of the rule, and you know, tweaked a few things, and adopted

5 it. The release is 11-414, the date is October 28, 1980.

6 And just sort of three final comments about the
7 rule, as it was adopted. Again, the Commission tried to
8 address the issue of direct versus indirect. That is, to
9 what extent can the adviser, or other third-party recipient
10 use its own assets to promote distribution.

11 The Commission again said, "You know, there can't
12 be an allowance in the fee for distribution, there can't be
13 inflation of the fee for distribution, there can't be an
14 arrangement that a third party who receives money from the
15 fund is acting as a conduit" -- I guess I should say a second
16 party is acting as a conduit for payments through.

17 But the bottom line was that if the fee met the
18 applicable legal standard -- in the case of advisory fees, it
19 is, of course, section 36B -- the recipient of that fee could
20 use the assets, use its resources as it saw fit.

21 Second thing on the role of the board, the
22 Commission stressed that this was a business decision,
23 stressed the Commission was not going to regulate the amount
24 or the nature of 12b-1 fees. A clear expectation that people
25 would use their imagination in coming up with things that

1 were, in fact, not anticipated at the time.

2 And the role of the board was strengthened through
3 the adoption of the requirement that the independent
4 directors essentially had to nominate the other independent
5 directors, to try to decrease the degree to which management
6 had overreached the board, by threatening their tenure.

7 Finally, the rule had -- as proposed -- had

8 contained some factors. And not surprisingly -- this may
9 come as a surprise to people, but sometimes regulators put
10 things in rules that they expect to back off from, you know,
11 to give the public something to chew on, an objective. The
12 factors came out of the rule, because the -- and we will put
13 into the release, as general guidance.

14 The concerns the Commission expressed at that point
15 was they did not want to constrict the business judgement of
16 the board, and they did not want to provide a mechanical
17 checklist for compliance, either.

18 The other thing I would say about the factors is
19 that they reflected the concerns at the time, in the sense
20 that they talk about problems that might be addressed by a
21 12b-1 fee. But they were clearly not regarded as a temporary
22 fix. Instead, to say it one more time, it was a basic
23 decision to let boards oversee a business judgement about how
24 to use the fund's assets to promote distribution.

25 MR. FINK: We have talked about some of the

1 myths -- temporary, not just for dealers -- some of which
2 seem to be promulgated by Matthew P. Fink in 2004, which I
3 will have to go back and look at, but there is another thing
4 I have heard. And that is not from directors on my board,
5 that, "My goodness, we cannot make these decisions, because
6 these factors do not fit."

7 And my own reaction -- when I went back and
8 researched this for a book I'm working on -- is the SEC
9 didn't say you have to meet these factors. The rule
10 expressly says these factors are suggestions, there may be

17 Resources saying, "We don't want to pretend we're paying it
18 out of advisory fee, we're taking it out of the fund."

19 So, I think a cap is the same as a prohibition,
20 analytically. It's very hard to make it stick.

21 MR. FINK: I will give you another example.
22 Transfer agent, or omnibus account, I don't know, load funds,
23 whatever we call them now, have a huge percentage, probably
24 60 or 70 percent of their shares, held in omnibus accounts by
25 brokers or 401(k) providers, who charge a fee per account.

1 Now, are you paying that fee for record-keeping?
2 Or, is part of it paying for distribution? Now what is that
3 fee to Schwab or Merrill Lynch for?

4 So, if you try to cabin it, and say, "No more than
5 X for distribution," what do you do about your omnibus
6 fee -- fee to your omnibus record keeper? What is that? I
7 think these kind of categories just don't work.

8 MR. SCHEIDT: Okay. So, the SEC adopted Rule 12b-1
9 in 1980. What did the industry do next? How did -- how many
10 funds quickly adopted 12b-1 plans, and what did they
11 initially use fund assets for?

12 MR. GRANT: I will let others to talk a little bit
13 more about the development, but my own impression is that, at
14 first, nobody used it. In fact, I think it was virtually a
15 year before anybody adopted a 12b-1 plan, because I think
16 that people really were quite concerned, you know, about what
17 it meant, what would the SEC's attitude be towards these
18 things? And, you know, what were the competitors going to
19 do?

20 So, it took a while before people were comfortable
21 enough to take those first steps.

22 MR. GOLDBERG: I think that's right. There was
23 surprisingly little use of the rule in the early years. And
24 it wasn't really until E.F. Hutton came in with its
25 application for contingent deferred sales load, a company

1 called "Hutton Investment Series," that was the first use of
2 12b-1 in conjunction with a contingent deferred sales load.
3 That sort of blew the lid off. But until then, there was
4 very little interest in the rule.

5 MR. FINK: Joel, can I -- a question, which I don't
6 know the answer to this. Merrill Lynch had the big money
7 market fund, Ready Assets.

8 MR. GOLDBERG: Yes.

9 MR. FINK: That had a 25 basis point trail for
10 brokers. And what I don't know -- maybe Tom Smith, sitting
11 there, will remember, or somebody else -- when that went on.
12 And I don't know the answer to that.

13 MR. GOLDBERG: It would have had to have been
14 after --

15 MR. FINK: Why?

16 MR. GOLDBERG: -- 12b-1.

17 MR. FINK: Oh, yes. It would have to be after
18 1980, but it may have happened before Hutton happened. Tom
19 is nodding, so I think that -- so I think it's hard to
20 collect that information, but my guess is that we may not
21 know everybody. I think the brokers were putting on trails
22 on their money funds. There were no-load money funds with

23 trails.

24 MR. GRANT: There was a fair amount of controversy
25 about that before the rule was adopted, because the view of

1 the staff, at least, was that if you were prohibiting mutual
2 fund payments for distribution, and if the adviser, or other
3 third party, had a fee that it was splitting in some sense
4 with sellers, wasn't that arrangement really a conduit for
5 the use of the fund assets?

6 So, both before and after adoption of the rule, the
7 staff was frequently off pursuing a rumor that one broker or
8 another was making these kinds of payments. And, of course,
9 we never could find it.

10 MR. SCHEIDT: It may have made sense, in the early
11 1980s, when interest rates were really high, and money market
12 funds were paying yields that were far higher than bank
13 accounts, for funds to look to those high yielding accounts
14 to be the first one to extract a small 25 basis-point fee.

15 MR. FINK: I don't know if that's true, but it
16 happened about that time. That's my recollection.

17 MR. SCHEIDT: Equity funds were still in a slump
18 from the 1970s, maybe starting to come out of it, but in a
19 high inflationary environment, they may not have had the
20 returns that would have made the imposition of 12b-1
21 fees -- at least large ones -- palatable with investors.

22 Well, Hamer Budget presaged the use of 12b-1 fees
23 with the contingent preferred sales loads, but it was legally
24 prohibited prior -- it was legally prohibited. And it
25 required E.F. Hutton Investment Series to come in for an

1 exemptive order to allow funds to do what the insurance
2 industry had done previously.

3 So, Joel, can you describe those events, briefly?

4 MR. GOLDBERG: Well, the precise prohibitions that
5 would have prevented a contingent deferred sales load were
6 somewhat unclear. I think Hutton recognized that this was a
7 very aggressive and unusual use of 12b-1, so they filed an
8 exemptive application under various sections of the Act.

9 But there was nothing specifically prohibiting this
10 type of arrangement. Essentially, what it involved was
11 advancing a sales commission to the broker. And then, if the
12 investor redeemed within the stated period -- let's say, six
13 years -- they would have to pay a sales load on the way out.
14 Otherwise, the fund would pay what, at the time, seemed like
15 an extraordinarily high 12b-1 fee to recompense the
16 distributor for having advanced the sales commission.

17 Hutton's 12b-1 plan, I believe, was 100 points. I
18 might be a little off on that, but -- and that was just way
19 beyond what anyone had envisioned.

20 I will confess that that application was issued by
21 the staff under delegated authority without going to the
22 Commission, should have gone to the Commission. The people
23 processing it just didn't recognize its significance.

24 We did recognize its significance after it was
25 issued, and the final order was granted by the Commission.

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1 But I think it's unfortunate that the notice was issued
2 without the Commission seeing it.

3 MR. SCHEIDT: So, within two years of the adoption
4 of Rule 12b-1, the brilliant minds in the industry had come
5 up with a new way to use 12b-1 fees as a substitute for
6 front-end sales load?

7 MR. FINK: This is a little bit off, but I have to
8 say this was the creation of one person who was -- I just
9 want to give somebody credit here -- Gary Strum, who had been
10 an attorney at Lord Abbott for years, left there to go to
11 Hutton, and dreamt it up.

12 And his boss at Lord Abbott, Ron Lynch, was a very
13 good guy. And Lynch once said to me, "Strum was the
14 brightest guy I ever had work for me. Thank God he left,
15 because he would have bankrupted me." So that was quite
16 an -- he was the one person who thought of this.

17 MR. GOLDBERG: Well, one of the characteristics of
18 contingent deferred sales loads -- and it caught some people
19 in the industry by surprise -- is that the more shares you
20 sold, the more money you lost.

21 MR. FINK: Right.

22 MR. GOLDBERG: Because the distributor had to
23 advance the sales commission, and it would take years to get
24 it back. And it's like the old joke that "I sell suits way
25 below cost," you know, "How do you stay in business?" "I do

1 it on volume." And many people in the industry discovered
2 that about contingent deferred sales loads.

3 MR. GRANT: So, the 12b-1 fee was used to pay the
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4 principal underwriter of the fund, who had advanced monies to
5 the dealers who had sold fund shares.

6 MR. GOLDBERG: Yes, that's correct, and it involved
7 a little bit of a Procrustean application of 12b-1, because
8 12b-1, as you know, says that the plan can continue, in
9 effect, only if it's renewed annually by the board. And,
10 even then, it can be terminated at any time by the board.

11 So, every year, the board goes through this
12 pretense -- I will use that word -- of, "Should we renew the
13 plan?" Well, the distributor has advanced millions of
14 dollars for contingent deferred sales loads. If the board
15 said, "Gee, we have decided not to renew the plan, we're not
16 going to pay you back this money," the distributor would be,
17 shall we say, surprised.

18 MR. GRANT: Of course, even a traditional A share,
19 as they're sold now with a sales load in a 12b-1 plan, it's
20 very difficult for a board to decide, "Well, we're going to
21 discontinue it this year," because, of course, all those
22 people who sold it originally are receiving those ongoing
23 fees, and seeing themselves now as asset-gatherers. You stop
24 paying them that fee, they're going to find another fund.

25 MR. GOLDBERG: Yes, I think --

1 MR. GRANT: So, a zero-based revisiting of these
2 fees is really not practical.

3 MR. GOLDBERG: I think the notion that a 12b-1 plan
4 is a year-to-year thing, and is redecided every year, is a
5 little bit of fiction.

6 MR. SCHEIDT: Well, that's true, when it's used as
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7 a substitute for front-end sales load.

8 MR. GOLDBERG: Or, as Dick described, for a
9 trial --

10 MR. SCHEIDT: Yes.

11 MR. GOLDBERG: -- where the broker expects it to
12 continue.

13 MR. SCHEIDT: But it's not necessarily true, is it,
14 when fund assets would be used for advertising expenses?

15 MR. GOLDBERG: No, no. And that's what the
16 Commission was anticipating. That's why the rule has these
17 provisions, because they thought it would be advertising,
18 training of sales people, that kind of thing.

19 MR. GRANT: I think it is still a business decision
20 that they can grapple with, it's just a question of being
21 able to take a business-like approach to it, as opposed to
22 sort of a theoretical or conceptual approach to it.

23 MR. SCHEIDT: Okay. Let us forward a couple of
24 more years and Kathie McGrath is on the scene in 1983.

25 MS. MCGRATH: Yes. I came back to the Commission

1 in the division of investment management in the summer of
2 1983, and things were pretty quiet on the 12b-1 front, at
3 least at first.

4 But by 1985, some problems had begun to surface.
5 The first thing I remember getting upset about was one fund
6 group proudly went to a conference and explained to everyone
7 how they had figured out a new method of boosting their
8 performance yield by capitalizing on their 12b-1 fees,
9 instead of expensing them.

10 And so, we had to run off -- since they just
11 explained to the entire industry how to do that -- and get
12 the chief accountant's office to put a stop to it.

13 But then, in the fall of 1985, I was presented with
14 a memo by a division staff outlining what they referred to as
15 the "use and abuse" of 12b-1, and proposing solutions, chief
16 among which was a repeal of the rule, and going back to the
17 idea of allowing advisers to use their advisory fees to pay
18 for distribution.

19 The end of 1985, there were about 600 funds with
20 12b-1 fees. The amounts had gone up, in some cases, up to
21 125 basis points. And they were being used to pay brokers'
22 sales commissions up front, which, of course, the rule
23 permitted, and were being combined with back-end loads.

24 They weren't very well disclosed, and the press got
25 onto the bandwagon, and there were numerous articles

1 excoriating the fund industry, and the SEC staff for allowing
2 these hidden loads. And then, the mail from Congress started
3 arriving, and lots of small investors, surprisingly enough.

4 One thing that got everybody riled up was the fact
5 that funds who were charging these fees and using them to pay
6 salesmen in, you know, amounts of 125 basis points, which
7 pretty quickly got up to where sales loads were, were
8 advertising themselves heavily as no-load funds. And the SEC
9 said that Vanguard could do this, in an order, with its 25
10 basis points. So we didn't think we could stop it. But we
11 thought it was a problem.

12 So, the SEC had promised, when it adopted the rule,
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13 to monitor it. So we decided we needed to take a look, and
14 we did so through the disclosure office, which looks at
15 prospectuses, and also the regional offices. And we found
16 some things we didn't like. We thought they were problems;
17 others didn't.

18 One was, of course, the no-load advertising
19 campaign. The second was on these 12b-1 fees that were
20 paired with contingent deferred sales loads. The
21 distributors were fronting an awful lot of money. And in
22 order to get that paid back, the 12b-1 plans needed to go on
23 for a long time.

24 And they were also charging the funds interest,
25 financing charges, which made it an even larger amount that

1 would have to be paid back. And we thought this was
2 inconsistent with what the Commission had laid out, which was
3 these things had to be re-approved every year.

4 And then, investors were not being told, in the
5 prospectuses or anywhere else, about these finance charges
6 and the sort of long-term nature of the 12b-1 plans. So, we
7 also saw some situations in which these combinations of sales
8 charges resulted in spectacular growth, but there weren't any
9 break points or reductions in advisory fees coming as a
10 result.

11 And then, we saw another type of 12b-1 plan that we
12 called a compensation plan, and that's basically where the
13 fund board said, "Here is money we're going to give you.
14 Take it, Mr. Distributor, and spend it how you please." But
15 they really weren't required to return any unspent monies,

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16 and we had some problems with that.

17 So, we did a couple of things, initially. We
18 started asking for additional disclosure about how these
19 finance charges worked, what amounts were being carried
20 forward, how long a 12b-1 plan would have to go on in the
21 prospectus, through the comment process.

22 We saw some issues with how the 12b-1 fees were
23 being used, where they collected from one series of a fund,
24 and then use it to pay for distribution of a separate series.
25 And we found some bad facts.

1 In one case, where the distributor spent the money
2 on, you know, dinner, flowers, a car wash, dry cleaning,
3 chocolates, health club memberships, you know, and you sort
4 of said, "Well, gee, a distributor must figure that a buff,
5 well-fed guy in a neatly pressed suit must be able to sell
6 more shares." But then we said, "Maybe they meant to bill it
7 to the soft dollar account, and made a mistake."

8 So, we looked at board records, to try to figure
9 out what directors were being told. And in a number of
10 instances, the specifics weren't there.

11 We found plans that had lapsed, but the money kept
12 on being paid, and some cases where they accrued and took
13 from the funds 12b-1 fees, or deducted them from NAV, but
14 never spent the money, and we had to go beat the fund up to
15 get the money back.

16 But we managed to put a stop to the use of the
17 no-load advertising label with contingent deferred sales
18 loads through a letter, but we still felt we weren't able to

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19 do anything on the fact that a fund had a very large 12b-1
20 fee.

21 We hit upon the idea of asking the NASD to take
22 care of some of these concerns. It seemed inconsistent to us
23 that the NASD would have these rules that said, "A front-end
24 sales load in excess of this amount is excess of this amount
25 is excessive, and brokers can't charge it," but not to have

1 any governor at all on the amounts that could be collected
2 through contingent deferred sales loads, or asset-based 12b-1
3 fees.

4 And also, the NASD was, at that point, taking over
5 the review of fund advertising. So they seemed like a
6 logical place to go. But we talked to them for a couple of
7 years, and they insisted that they had no jurisdiction over
8 anything but front-end loads.

9 So, we went ahead with a fee table for the
10 prospectus, which we thought would help investors get a
11 handle on what they were paying in 12b-1 fees, and other
12 costs of investing in a fund. And we kept getting pounded by
13 the Congress and the press. I noted somewhere in a speech
14 that we had gotten 65 inquiries from members of Congress on
15 the subject, and I lost count of the press articles.

16 After a while, the press actually did a lot of
17 good. They increased investor awareness of 12b-1 fees, which
18 was all to the better, and they had an effect on the use of
19 the no-load label, because they would write nasty articles
20 every time somebody did it. And, in fact, I found a
21 prospectus in an old file from 1987, and this is what the

22 fund started advertising. This was their new
23 promotion -- the heat had gotten so bad -- "No 12b-1."

24 So, in 1988, we gave up butting heads with the NASD
25 over its jurisdiction, and put out our own rule proposal.

1 And I remember that one of the first outlines of it that I
2 got was titled by the division staff, "Seven Ways to Tighten
3 the Screws," which should tell you what kind of a mood we
4 were in at that point; it was not good.

5 And it was more or less a failed proposal, but here
6 is what we proposed to do. We said, "Unreimbursed
7 distribution expenses going forward would have to be paid
8 back within a year." This was sort of an effort to try to
9 make sure the costs fell on, generally, the right group of
10 shareholders.

11 To deal with compensation plans, we said, "No, your
12 plan has to spell out what you can spend the money for. And
13 if you don't use it for those things, you've got to give it
14 back to the fund."

15 To deal with how much any one investor could be
16 charged between 12b-1 fees, front-end/back-end loads, we
17 basically cooked up something that said that in setting
18 amounts of 12b-1 fees, the board needed to look at the NASD
19 sales limits, and kind of figure what an investor would pay
20 overall, and take that into account.

21 We proposed annual shareholder approval of the
22 plan -- that was the nastiest one -- and, of course, no more
23 no-load labels.

24 Well, in face of the seven screws, the NASD had a
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25 miraculous change of heart about the scope of its

1 jurisdiction. And a committee headed by Ron Lynch came over
2 and asked if we could smoke the peace pipe, and if we would
3 defer action on our rule proposal and let them take a crack
4 at it.

5 So, I talked to the chairman and a couple of the
6 commissioners, and they said, "Okay," and they came back
7 fairly promptly -- within a year -- with a proposal that got
8 at most of what we were concerned about. But then it took
9 them until 1983 to get it on the books -- 1993. I left in
10 1990.

11 So, they did put the brakes on it, to some extent.
12 They kind of did a rough justice limit, so you had to take
13 into account front-end loads, back-end loads, 12b-1 fees.
14 They allowed 25 basis-point service fees to go on ad
15 infinitum, not subject to the cap, and you know, by and
16 large, they limited what funds could pay, rather than what an
17 individual shareholder could be charged.

18 So, it didn't perfectly resolve the concern that
19 the money was falling on the wrong shareholders. But in
20 those days, computer programs and accounting systems really
21 were not up to trying to do something on a
22 shareholder-by-shareholder basis.

23 My two cents on all of this, you know, Americans
24 like to pay on time. And most investors really don't know
25 how long they're going to stay in a fund. So -- and one of

1 the reasons they buy mutual funds is because they know they
2 can get out whenever they want. So, you know, I don't think
3 front-end loads are the answer. People hate them. They also
4 don't like deferred sales loads, because that causes them to
5 feel they're stuck.

6 So, it would be nice if something could be worked
7 out to continue asset-based fees, if we can figure out how to
8 clearly explain them to investors so they know what they're
9 paying, and what they're getting. And we haven't gotten that
10 right yet. Anyway, I left in 1990, so --

11 MR. SCHEIDT: Why were the other proposals
12 failures? Did you get the sense that, by focusing attention
13 on these issues, the industry responded, if there was concern
14 about reimbursement plans, or about compensation plans, and
15 your concern was that directors didn't pay enough attention?
16 Did you get the sense that merely by focusing attention on
17 those issues, directors paid more attention?

18 MS. MCGRATH: No. I mean, I don't really think
19 they -- everybody seemed to think I was crazy. I think what
20 really had an impact was the financial press that came to be
21 directed to individual investors. And they took up the
22 cause, and they got a lot more attention.

23 In fact, we found it very useful. It was a way of
24 educating investors. "Money Magazine" was good at it, a lot
25 of people read that. And it was a way to get the word out

1 that the SEC really couldn't -- they would follow what was

2 going on with 12b-1 and write about it. It was a good thing.

3 MR. SCHEIDT: You also mentioned that the computer
4 systems at the time weren't sophisticated enough to
5 individualize account treatment.

6 I noticed, Matt -- and maybe you remember -- the
7 ICI filed a statement in connection with a 1988 rule
8 proposal, in which it raised the issue of imposing 12b-1-like
9 fees at the shareholder account level, but argued that doing
10 so would be operationally impractical, expensive, and
11 burdensome. So there were some --

12 MR. FINK: We looked at it. And I just remember
13 one large member thought that they could do it in a couple of
14 years, and the others said they could not do it.

15 MR. SCHEIDT: Okay. We're --

16 MS. MCGRATH: I think that was true, that the
17 accounting systems at the time were just not up to doing it,
18 across the industry. Either that, or they really fooled me.

19 MR. SCHEIDT: Okay. We have come to the end of our
20 historical perspective on Rule 12b-1, and this is the time
21 when the individual panelists are invited to make brief
22 personal remarks on their views -- who would like to start?

23 MR. GOLDBERG: Let me say first what I think should
24 not be done. I think an attempt to go back to prohibiting or
25 limiting to a specific amount the bearing of distribution

1 expenses by mutual funds is an imaginary line. It will
2 survive only until somebody tests it. And we found that,
3 historically, the evolution through Banner Ready Resources.

4 So, the question is, "What should be done?" I

5 personally would advocate bifurcating 12b-1 into two parts.

6 One, where it's used as a substitute for a sales
7 load, a contingent deferred sales load, a level load, I think
8 there we should drop the pretense that the plan is a
9 temporary thing that is in existence for only a year at a
10 time, and is subject to termination. It's a contract.
11 People have advanced money on the understanding it will be
12 repaid. And, in fact, people are so sure it will be repaid,
13 that the 12b-1 stream is sometimes used as security for a
14 loan.

15 Obviously, nobody believes the pretense that the
16 board won't continue a 12b-1 plan in those circumstances. So
17 let's call it what it is, a contractual obligation on the
18 part of the fund to pay back a certain amount of money.

19 Now, we might call the originally anticipated 12b-1
20 plans advertising the type of expenses that can be terminated
21 at will. There, I would keep 12b-1 in pretty much its
22 present form. But the factors that Dick labored so hard to
23 write in 1980, I think could use a serious updating.

24 MR. FINK: Thanks. I will stick to the subject of
25 this panel history, and not try to offer solutions. I must

1 say I have come up with solutions that will satisfy the SEC,
2 most importantly, the investors, the media, and the industry,
3 but you will have to read my book on the history of the
4 industry to get those.

5 So, for now, I will stick with history. In the
6 time -- I've been doing a lot of reading on history, and read
7 a lot of books on the British Empire. And it has often been

8 observed that the British Empire was created "in a fit of
9 absent-mindedness." Some observers similarly maintain that
10 the SEC somehow was absent-minded in 1980 when it authorized
11 12b-1 plans, and didn't realize what it was giving creation
12 to.

13 Specifically -- and you read these observers
14 -- they say the SEC thought that 12b-1 plans would be
15 temporary, that they would be confined to the problem of net
16 redemptions, that they would not be used to compensate
17 dealers.

18 Moreover, they claim that this absent-mindedness
19 has continued over the last 27 years, and the SEC has never
20 revisited the issue. And, finally, they say the SEC clearly
21 wasn't focused, because it imposed impossible conditions on
22 fund directors.

23 But if you look at the historical record -- which
24 I, frankly, was doing before these hearings this excellent
25 roundtable was called -- all of these are not true. The

1 record -- and you've heard from the two authors of the rule
2 here, two principal authors -- the historical written record
3 shows that the SEC did not assume that the plans would be
4 temporary.

5 The SEC did not assume that the plans would be
6 restricted solely to address net redemptions. The SEC
7 clearly contemplated, and expressly says in the rule that the
8 fees would be used to compensate dealers. As a fund
9 director, I can tell you that the SEC has not required
10 directors to make virtually impossible findings.

20 Research and Management Company, as well as Chairman of the
21 firm's executive committee. Paul is also an officer and
22 director of several funds in the American Funds group, which
23 is managed by Capital Research. With more than \$1 trillion
24 under management, it's one of our larger fund groups in the
25 country.

1 Melody Hobson is President of Ariel Capital
2 Management, a Chicago-based mutual fund company and
3 investment management firm. Ariel Capital Management is the
4 investment adviser to the Ariel Mutual Funds, which have more
5 than \$7 billion in assets under management. Although \$7
6 billion seems like a lot of money to most of us, in this
7 group, Ariel Capital Management and Melody is the
8 representative of one of our smaller fund groups here, and
9 will speak to the issues of 12b-1 to those small fund groups.

10 John Morris is Senior Vice President, Asset
11 Management Products and Services, at Charles Schwab &
12 Company. In addition to its discount brokerage business,
13 Schwab offers the OneSource program, the largest mutual fund
14 supermarket, which allows investors to invest in a wide
15 choice of mutual funds in a single account, and those
16 services are intricately related to 12b-1 plans.

17 Charlie Nelson is Senior Vice President of
18 Great-West Retirement Services, a division of Great-West Life
19 and Annuity Insurance Company. Among the largest 401(k)
20 providers, Great-West provides retirement products and
21 services. At the end of 2006, \$1.5 trillion were invested in
22 mutual funds through 401(k) plans, and they provide a

23 significant portion of the distribution of mutual funds in
24 the United States.

25 Tom Selman is Executive Vice President, Investment

1 Companies Corporate Financing at NASD Regulation. NASD is an
2 SRO of securities firms; it plays a very important role in
3 12b-1 matters because it has adopted for its members rules
4 that limit the distribution and services of mutual funds that
5 brokers can sell, in addition to being responsible for mutual
6 fund advertising, which was alluded to in the last panel.

7 And, finally, but not last, Bob Uek is an
8 independent trustee on the board of trustees of the MFS
9 family of funds. MFS Funds, which include the first mutual
10 fund in the United States, have over \$120 billion of assets
11 under management.

12 Let's start right off here with the current model.
13 Our Rule 12b-1 plans today typically work in conjunction with
14 multiple classes issued by the same fund. I think there may
15 have been some allusion to that in the first panel, but this
16 is where we're going to dig into it, how it operates.

17 Paul Haaga, could you describe, generally, some of
18 the classes that are offered to retail investors, and the
19 role 12b-1 plans play with each?

20 MR. HAAGA: Sure. Thank you. And thank you very
21 much for having me on the panel, Bob, and Commissioners,
22 thank you.

23 I have a hand-out, and I am not going to walk you
24 through it, but I hope everybody has a copy of it. It gives,
25 on one side, what the investor pays, either directly or

1 through the fund, and how they pay it. And then, on the
2 other side, it has by whom the payment is received.

3 But let me just talk generally about it. I can
4 circle back and answer questions about specific fees and
5 classes that are listed here.

6 I think this roundtable would be greatly improved,
7 the whole thing, if no one were allowed to say the word
8 "12b-1 fees." Because every time it gets said, people think
9 of different things. 12b-1 happens to be the rule. There
10 are really three basic expenses, or fees, or bits of
11 compensation that come out of 12b-1, and we really ought to
12 separate them. And I hope someone will raise their hand, or
13 say something if I use the word "12b-1 fees."

14 There are -- the three kinds are -- ongoing service
15 fees. Those are often 25 basis points in A shares. They are
16 paid forever, they are excluded from the NASD maximum sales
17 charge rule. They are 25 basis points on A shares. They're
18 often higher on retirement shares, and you can see that from
19 our piece here.

20 The second is what I will call spread loads. Those
21 are -- actually, they're a commission, they're
22 transaction-based payments that happen to be spread out over
23 time. They're paid on B, and to some extent, C shares.
24 Think of them as the spread loads. Those are the ones that
25 are financed by the 12b-1 plan.

12b1transcript

1 I might add that when Kathie McGrath talked about
2 1988 and all the problems, everything she talked about was B
3 shares. It was all spread loads. She didn't say a word
4 about the 25 basis-point ongoing service fees, and I think
5 it's important to distinguish.

6 And then, the last is the classic advertising
7 expense, the one that Vanguard pioneered through their
8 17(b)(3) order. But some other people have picked up it's a
9 much smaller mark.

10 The other thing I would like to say about it
11 -- and it does relate to the types of classes -- is that I
12 think our vocabulary traps us in thinking about this, what
13 this is paying for, as being just something that takes place
14 at the point of sale -- or I will call it the "opening of the
15 account." But we have to devise a system that includes
16 compensation for the entire relationship, the entire period
17 of relationship, between the personal adviser or broker-
18 dealer, and the investor.

19 The up-front transaction opening of the account,
20 initial purchase, is probably the least important time in
21 that relationship. The most important, by far, is the end of
22 the relationship, when -- or the back end of the
23 relationship -- when the investor is taking money out of the
24 fund, and seeking to do so without outliving their assets.
25 That's when they need the most advice.

1 And we have to have a system that pays for that.
2 And, by the way, it's the one period when there are no more
3 transactions. So if all of our compensation is based on

4 transactions occurring, it's not going to happen, then there
5 is going to be no motivation to keep that.

6 Lastly, I heard someone refer in the first
7 panel -- refer to the old argument, "Does it benefit existing
8 shareholders to have more assets come into the fund?" You
9 can debate both sides of that, but I don't think it's
10 relevant here.

11 I could concede to you that it doesn't benefit
12 existing shareholders to have assets come into the fund. And
13 I could still argue that a service fee payment to that
14 person's adviser, and every other person's adviser, paid on
15 an internalized basis, is a good thing to have, and it
16 couldn't matter less how many assets are coming into the
17 fund, or not coming into the fund.

18 And finally, I just -- one other comment about the
19 earlier panel. There were some negative comments about the
20 role of directors in annually renewing the plan. And the
21 underlying assumption there was that directors have two
22 choices: continue the plan exactly as is; or terminate it
23 completely. And that isn't what goes on in the renewal.

24 There are many other choices, including: modify
25 the plan; cut off sales of B shares and let the other ones

1 roll off while paying the outstanding fees. That's a
2 perfectly reasonable way to do it.

3 I will just give you a couple examples of when
4 modification has happened, even without cutting it off. The
5 early B shares did not convert to A shares after a period of
6 years. After several years of Merrill Lynch funds that had B

7 shares, their directors observed -- the independent directors
8 observed -- that they had been repaid for a lot of their
9 up-front commissions, and said, "What next?"

10 And from that was born the practice that is now
11 universal, of converting into A shares, so that only the 25
12 basis-point service fee would be paid by those investors
13 after their early 1 percents.

14 A very small part of our A-share 12b-1 -- a couple
15 of basis points -- goes to pay commissions on very large
16 accounts. They start at one percent, and drop below that for
17 million dollar-plus accounts. In conversations with our
18 directors, as those crept up over the years, we made several
19 modifications, and removed most, but not all, of the
20 recipients of those fees from the A share classes.

21 We put them in -- our shares and others in
22 quick-paying net transaction-based compensation. That was
23 based on a conversation with directors, that was based on
24 annual renewal. But it didn't involve the binary decision of
25 keep it or cut it off. So I hope we will think a little more

1 broadly and a little more nuanced about that.

2 Let me stop there, and just refer everybody to the
3 piece of paper.

4 MR. PLAZE: Purchase a portfolio of, say, common
5 stocks from a broker. I pay the broker a commission, the
6 amount of which I am free, by law, to negotiate or accept
7 their -- whichever broker I wish to.

8 When I buy a portfolio of mutual fund shares, the
9 way 12b-1 operates, I actually pay a sales load to the

10 issuer, and then pay assets to the issuer, which are then
11 directed back to the broker at amounts established by the
12 fund. I have three payment programs -- class A shares;
13 class B shares; class C shares.

14 Why is this so different in the mutual fund
15 industry than if you were buying common stocks? Which, I
16 might add, you will need advice about in your dotage, also?

17 MR. HAAGA: You are referring to the -- just to the
18 transaction-based payments, not ongoing fees. It's
19 operational, the reason that the brokers don't collect the
20 sales charges, we collect them, is because we are actually
21 maintaining the records and keeping the books. We're the
22 only people who can collect them, particularly if there are
23 follow-up payments for which a sales charge will be
24 collected. That's why 22-D existed.

25 Now, as -- over the years, it has happened that

1 brokers have begun to maintain street name accounts that keep
2 the accounts by name. They could start collecting the fees,
3 the brokerage commissions. They haven't, but they could
4 start collecting them.

5 MR. PLAZE: Martin, could you -- we all know that
6 funds pay 12b-1's and ultimately fund shareholders pay 12b-1
7 fees, and they're disseminated through a distribution
8 network. Can you explain how that works? I am particularly
9 interested in how that affects net asset value, and then how
10 the net distributions are made.

11 MR. BYRNE: I guess let me step back just a minute,
12 and just set out what I will assume are the usual

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13 arrangements.

14 A fund usually enters into a distribution agreement
15 with its principal underwriter, or fund distributor. Many
16 times it's an affiliate of the management company. That
17 company -- and that is the agreement and arrangement pursuant
18 to which 12b-1's are paid. So they're paid from the fund to
19 the principal underwriter. And then, typically, the
20 principal underwriter will enter into arrangements with
21 intermediaries who sell the funds.

22 So, with that, I will go into how it actually
23 works. Each day, the fund accountants will accrue the
24 appropriate 12b-1 fee for the particular class, based on the
25 NAV at the end of the day, to strike the NAV. Therefore, on

1 a daily basis, the fund's NAV assumes that daily payment,
2 because it's an accrued liability.

3 Once a month -- well, let me step back. As an
4 example, in a class A share, that would be 25 basis points
5 accrued each day. And for a class B and C share, that would
6 be 100 basis points accrued each day. Once a month, based on
7 all those accruals, the fund will pay the fund distributor
8 those amounts. And then, the fund, the principal
9 underwriter, is responsible for paying the financial
10 intermediaries.

11 Now, what they will end up paying the financial
12 intermediaries depends on the class. And starting with my
13 previous example, for a class A share, they will usually pass
14 along 25 basis points to the intermediary.

15 In a class B share -- and we really didn't go into

16 this -- there is usually an up-front payment to the broker.
17 So, in a B share, the principal underwriter typically retains
18 75 basis points of the 100, and passes along a 25 basis-point
19 trail to the selling broker-dealer, or other intermediary.

20 On a C share, because of the way a C share works,
21 there is an up-front compensation to the broker of one
22 percent for the first year of the -- since the initial
23 purchase, the fund company, fund distributor, will retain the
24 entire 100 basis points, because it up-fronted 1 percent to
25 the financial intermediary. Thereafter, the payments will be

1 one percent to the selling dealer.

2 MR. PLAZE: What kind of investors are each of
3 these classes designed to meet the needs of?

4 MR. BYRNE: It depends what their preferences are,
5 right?

6 MR. PLAZE: Right.

7 MR. BYRNE: As we heard from the previous panel, a
8 lot of investors don't like to pay up-front loads,
9 so -- because they don't know how long they're going to want
10 to be in a fund. So, they will want to defer their payments
11 of the service fees and distribution fees.

12 Now, from an economic standpoint, A shares are
13 probably best, economically, for folks who are going to
14 purchase over \$100,000 in an equity fund, or \$50,000 in a
15 fixed income fund for intermediate to longer periods of time,
16 because of the break points. A B share --

17 MR. PLAZE: Could you explain the break points, for
18 a moment?

19 MR. BYRNE: Usually, there is a maximum front-end
20 sales load, which could be, let's say, 5.25 percent. Based
21 on if a person purchases certain levels, purchases in volume,
22 they get a reduced sales load. So, often times, the first
23 break point is either at \$25,000 and \$50,000.

24 And if a person, on a cumulative basis, purchases
25 up to that amount, their initial sales charge is reduced. So

1 it will reduce in increments all the way to zero, typically
2 at one million dollars.

3 MR. PLAZE: So, a person eligible can actually be
4 drawn to -- you have an economic interest in buying A shares.
5 B shares people who want to avoid paying up front have their
6 money go to work early. What role do C shares play?

7 MR. BYRNE: One more thing. B shares are not only
8 for people that want to defer. B shares could be
9 economically better for someone who is buying lower amounts.
10 So, the person who only wants \$25,000, and has a long horizon
11 because of the way B shares convert to As, they would often
12 be better buying a B share, long term, than the A share.

13 C shares, because of the compensation structure of
14 one percent a year, are most economical for folks with
15 relatively shorter -- short to intermediate -- time frames,
16 and in amounts under one million.

17 MR. PLAZE: How do investors figure out which of
18 these three classes is in their interest?

19 MR. BYRNE: Well, at a firm like ours they talk
20 with their FA. We have tools to help them. The NASD has a
21 tool to help investors considering their proposed holding

1 consultants who sell our funds. They may be selling direct
2 as independent organizations, or they may be selling through
3 the large brokerage firms.

4 Secondly, we pay the supermarkets, the Schwabs and
5 Fidelities of the world, that clearly offer the platform for
6 the convenience of customers that like the combined
7 statement.

8 Thirdly, we pay the 401(k) plan administrators.
9 Now, this has become an increasingly important part of our
10 business, as defined benefit plans have gone away, more and
11 more.

12 And, specifically, it's the only reason, having
13 that 12b-1 fee plan, that we can be in the plans at Wal-Mart
14 and General Motors, alongside other gigantic mutual fund
15 companies, like Fidelity and others. And we would argue
16 that, really, the playing field is completely level when a
17 small fund company, like Ariel, can be added at no cost to
18 the plan or the participant, because 12b-1 exists, and can be
19 passed on to help with the administrative costs.

20 Last, but not least, we use our 12b-1 fee to offset
21 our internal marketing costs, and those generally come from
22 our direct shareholders, which, I remind you, is only 10
23 percent of the shareholders that we have, in total. And so,
24 that pays for our web site, it pays for the phone service
25 that our shareholders get from any source that they may use,

1 to call and request information from Ariel. It pays for our

2 marketing materials, it pays for our advertising.

3 The one thing that we have heard people say is that
4 this is a profit center for mutual fund companies. Well, the
5 math does not suggest a profit center for us. We spend in
6 excess of our 12b-1 fee each and every year.

7 And to give you a sense of the magnitude of that
8 spent, last year we spent \$2.9 million in excess of our 12b-1
9 fees on ongoing marketing, and marketing-related
10 opportunities in order to grow the funds, which ultimately,
11 of course, decreases their expense ratio for our
12 shareholders.

13 Lastly, I would just argue that once a fund is
14 sold, we know, firsthand, that the work is not done, it is
15 not over. And there is an ongoing relationship that has to
16 be maintained. Either the financial consultant who is
17 offering that ongoing advice; the supermarket that is
18 providing that wonderful convenience and simplified
19 statement; or firms like Ariel, ourselves, in dealing with
20 the direct customer.

21 And then, last but not least, since we know that
22 four out of five mutual fund customers seek advice when
23 buying a fund, I did want to add one nuance to this
24 discussion I think that is largely missing on conversations
25 about mutual fund and investing, and it's a result of

1 actually pioneering research that Ariel has done with Charles
2 Schwab and Company, where we have actually studied black
3 investors for the last decade, when no one else has.

4 And the one thing we know about black investors is

5 they're more likely than even the majority population to seek
6 advice, because we tend to be novice investors. And so, that
7 advice component, and to be paying for that advice, we would
8 suggest, is money actually very well spent.

9 Last, but not least, in the context of my role as
10 financial contributor on "ABC News," and weekly on-air person
11 for "Good Morning, America," talking about the stock market
12 and investing, I literally get hundreds of letters from
13 investors on various topics. And I have said this before. I
14 have never gotten a letter on a 12b-1 fee. But I have gotten
15 a lot of letters saying, "There are so many choices out
16 there. Help me understand, how do I decide?"

17 And, again, I would go back to the fact that that's
18 why that advice component is so important.

19 MR. UEK: Without repeating a lot of the things
20 that Melody talked about, I think MFS, which is a little bit
21 larger, in terms of its 40 Act fund business, is roughly \$100
22 billion. And in terms of what happens with all of its 12b-1,
23 MFS is a load shop, and depends almost exclusively in terms
24 of its distribution capabilities and strategies on 12b-1.

25 And of the 12b-1 fees that it collects, something

1 north of 95 percent of those are redistributed back through
2 the intermediaries, whether they be brokerage houses, or
3 independent financial consultants, or banks, or supermarket
4 platforms, et cetera.

5 Much like Melody's comments, the 12b-1, or
6 distribution capability or departments, if you will, of MFS
7 are not a profit-making organization, either. When you add

8 all the expenditures that they have, in addition to what they
9 pay out to intermediaries, they pay out a substantial amount
10 more money than what they take in, in 12b-1s. So it's not a
11 profit-making entity, nor is it even near a break-even
12 entity. The distribution costs are higher than the aggregate
13 12b-1s collected annually.

14 MR. PLAZE: That's interesting. The authors of the
15 1940 Act were concerned about underwriters -- mutual fund
16 underwriters -- being a profit center, inappropriate profit
17 center. And yet, history has shown them to be a loss center,
18 a loss in order to grow the assets of the fund, because the
19 profits are from the advisory fees.

20 MR. UEK: Well, I think if you stand back and look
21 at the last, say, 10 or 15 years, the cash flows have
22 migrated much stronger to the distribution end of the
23 business.

24 MR. PLAZE: Right.

25 MR. UEK: And away from the manufacturing. And I

1 think that's what is driving it, is to get your product sold.
2 And I think Melody made some very effective comments on
3 that.

4 To get your product sold is a very much more
5 expensive proposition today. And whereas 12b-1 has been
6 capped here for a number of years, and the cost of living
7 doesn't get any less in general, and the distributors demand
8 more, in terms of distributing the product, I think if we
9 took a survey around most brand name load shops, we would
10 find out that they were in a similar posture.

11 MR. PLAZE: Melody, the large fund shops, like MFS
12 and Cap Research, can pay the same 12b-1 fees to brokers to
13 sell their funds that you can.

14 Does it -- at the end of the day, do you sense that
15 it is a wash? That is, that Ariel Capital has to stand on
16 the quality of its management services and its performance
17 fees, because they're going to be able to match you, dollar
18 for dollar, for a fee you're going to be able pay your
19 broker. Or am I not getting something?

20 MS. HOBSON: Obviously, scale makes a difference in
21 any business. And so, if you're big, you can get
22 preferential treatment, because in the case of the brokerage
23 firms, they're obviously going to respond to MFS's call,
24 probably, before they respond to mine, just based upon the
25 actual revenues that we're both sending them.

1 So, dollar for dollar, yes, we are paying the same
2 amount. But in totality, the accumulated amounts are so much
3 different, that it can make a difference. And, obviously, in
4 the brokerage firms, scale also helps, in terms of brand name
5 and name recognition, which ultimately leads to more sales.

6 So, your goal, if you're Ariel, is to try to do
7 your best to get as many financial consultants in a wire
8 house to know you, so that, ultimately, you have the
9 opportunity to have them sell your fund, and allow you to
10 grow.

11 But I wouldn't say, on a dollar for dollar basis,
12 we are treated differently, with the exception of scale, if
13 that makes any sense to you.

20 help them select the right -- the appropriate funds for them,
21 and to monitor them over time.

22 To do that, it takes substantial infrastructure,
23 information, materials, tools, and other resources to support
24 the information flow regarding all of these different funds
25 and different share classes.

1 So, the 12b-1s in our firm are used, in part, to
2 compensate our financial advisors for their efforts with
3 clients, and to support the infrastructure, to allow both FAs
4 and clients to know and understand the funds. And I can give
5 you a few examples of things that we have available to
6 clients and FAs.

7 MR. PLAZE: Well, let me turn to a slightly
8 different direction here, if I can. The principal way
9 Merrill Lynch is compensated from the fund groups is either
10 from the collection of the sales load, or the stream of the
11 12b-1 fees from the fund companies. That's the principal --

12 MR. BYRNE: That's the combination.

13 MR. PLAZE: Combination.

14 MR. BYRNE: Right.

15 MR. PLAZE: That's the principal combination. But
16 there are other platforms available at Merrill Lynch in which
17 mutual funds are sold at net asset value, am I correct?

18 MR. BYRNE: Yes.

19 MR. PLAZE: Without fees --

20 MR. BYRNE: Correct.

21 MR. PLAZE: So, in one case, there is -- the
22 distribution system controlled by the mutual fund companies,

23 and the structure of the sales load to the 12b-1 fee. But
24 there are other platforms you have that sit side by side.

25 Could you explain some of those? Because I think

1 they're interesting, because operationally, there is another
2 kind of distribution that people may not be nearly as
3 familiar with.

4 MR. BYRNE: Are you referring to the --

5 MR. PLAZE: The programs were all distribution I
6 presume -- what kind of shares are sold to wrap fee programs?

7 MR. BYRNE: Yes. Typically, A shares
8 load-waived --

9 MR. PLAZE: Load-waived --

10 MR. BYRNE: -- with the wrap programs, and that is
11 consistent with the fund prospectuses that we would require a
12 fund to sell in one of our wrap programs, a fee waiver for
13 the shares sold in that program.

14 MR. PLAZE: And similarly, with the fee-based
15 accounts, which, of course, are at issue now.

16 MR. BYRNE: Correct. Right. So they are sold
17 through -- right. Our fee-based brokerage account has a mix
18 of individual securities, as well as funds in some of the
19 client accounts.

20 MR. PLAZE: They won't pay a sales load and they
21 won't generally pay a 12b-1 fee, either, will they?

22 MR. BYRNE: Well, it depends. Whether they pay a
23 12b-1 fee depends on the share class made available by the
24 fund's prospectus. So, if the prospectus makes A shares with
25 the 12b-1 available through the program, then it will be A

1 shares that will be sold. In certain cases, the fund
2 families will make 1 shares, or pure no-load funds available,
3 and those would be the ones.

4 We have a policy at Merrill Lynch always to choose
5 for those programs the lowest expense share class that is
6 available by the fund's prospectus for that program.

7 MR. PLAZE: So, in those platforms, in that
8 context, the distribution expense is all pretty much paid at
9 the account level, by the wrap fee, or whatever the fee is,
10 the fee-based brokerage -- the principal.

11 MR. BYRNE: Well, the client doesn't --

12 MR. PLAZE: Right.

13 MR. BYRNE: The client does pay a portion of it,
14 yes.

15 MR. PLAZE: Right. Now, you also sell ETFs,
16 correct?

17 MR. BYRNE: Yes.

18 MR. PLAZE: And ETFs, they pay a brokerage
19 commission. So the distribution component of an ETF
20 transaction is paid at the brokerage account level, not by
21 the fund.

22 MR. BYRNE: In a fee-based program, or --

23 MR. PLAZE: Any program.

24 MR. BYRNE: Well, in a fee-based program, they
25 wouldn't be paying a commission.

