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Wachovia Securities, LLC

May 12, 2004

Jonathan Katz, Secretary
Securities and Exchange Commission
450 Fifth Street, NW (6-9)
Washington, DC 20549

Re: Proposed Rule: Prohibition on the Use of Brokerage Commissions to Finance Distributions, Investment Company Act Release No. IC-26356 (hereinafter the “Proposing Release”) (S7-09-04)

Dear Mr. Katz:

Wachovia Securities, LLC (“Wachovia Securities”) appreciates the opportunity to comment on the above-referenced Proposing Release. While the main thrust of the Proposing Release concerns a ban on the use of brokerage commissions to finance mutual fund distributions, this comment letter will focus on that portion of the Proposing Release concerning eliminating or amending the rule’s authorization of other fees connected with the distribution of mutual funds. We strongly urge the Commission to retain the current ability for mutual funds, pursuant to Rule 12b-1¹, to deduct fees from fund assets to pay for the distribution of funds.

I. Introduction and Overview

Wachovia Securities is a full service brokerage firm serving clients in 49 states. It assists its 5.7 million active retail clients in purchasing a wide array of mutual fund products. The experience of Wachovia Securities mirrors that of the nation as a whole where many

¹ 17 CFR 270.12b-1.

citizens have made ownership of securities, primarily through mutual funds, a major component of their financial portfolios. The Commission has recognized that the distribution of funds is important to the overall success of a fund company, and thus it has permitted mutual funds, with the approval of its shareholders, to adopt 12b-1 plans that pay financial intermediaries such as Wachovia Securities to aid in the distribution of that fund's products. Since the SEC approved the concept of 12b-1 fees in 1980, additional rulemaking by both the NASD and the Commission has created our present system that places limits on the amount of 12b-1 fees charged as well as permitting their use in connection with the sale of multiple classes of mutual fund sales.² The firm is supportive of the concept that any fees charged investors in connection with the purchase of mutual funds should be disclosed clearly and fully.

II. Deducting Distribution-Related Costs Directly From Shareholders

One suggestion the Commission has made in the Proposing Release is that funds deduct distribution related costs directly from shareholders rather than from the mutual fund's assets. By example, it suggested that under a modified rule, on an investment of \$10,000 in a fund with a 5% sales load, the investor would have the option of paying \$500 up front or having the \$500 deducted periodically from the investor's account until paid. Before discussing this rule, it is important that the Commission note that the definition of marketing and distribution costs should clearly include the servicing of customers' mutual fund accounts³ in addition to the "community" benefits to all fund shareholders of having new investors in the fund. Viewed this way, the 12b-1 fee's goal of assisting fund distribution then does not necessarily translate directly to the effort to market to *that* individual investor. Funding such costs out of the individual investor accounts, as opposed to fund assets, therefore could be detrimental to all investors of a fund. It is not an issue, as noted in the Proposing Release, of investors individually receiving "few benefits" or paying more than their "fair share" of distribution costs.⁴ To pursue such a revision in the Rule that focuses on the individual alters considerably the traditional concept of joint and mutual experiences encompassed in the concept of "shareholder."

The Commission points out that the shareholder account-based approach to distribution payments helps eliminate conflicts of interest inherent in paying for those costs with fund assets. Presently, any perceived conflict in paying for distribution with fund assets is managed by the current rules⁵ designed for that very purpose. In addition, having fund directors monitor, and fund shareholders vote on, 12b-1 plans provides an

² See generally the Proposing Release at footnote 62 *infra*.

³ Services provided by those helping to distribute funds can include periodic statements that consolidate several investments; advice and counsel concerning selling or adding to the fund; assistance in obtaining year-end tax summaries; and reviews of an investor's other holdings and overall financial needs.

⁴ Proposing Release at 9732

⁵ See generally Rule 12b-1 and NASD Rule 2830(d)

additional mechanism to deal with the conflict. There is a concern that if the Commission focuses on eliminating manageable conflicts, it may greatly harm a system whereby investors are paying for distribution, service and advice that helps ensure the continued success of the funds they own.

The rule change in the Proposing Release might work better as an option mutual fund directors choose in lieu of the current system of asset-based payment of distribution fees. Modifying the rule to allow *either* asset-based or shareholder account-based funding might be the natural evolution for 12b-1 fees and be consistent with the Commission's promise at adoption to monitor how the rule operated. In this way, the thousands of funds as well as the millions of investors selecting among them could use the free-market system to choose the ways in which they wish to pay for distribution costs. Investors who would prefer to pay distribution costs directly out of their account could choose those funds permitting that alternative. With investors voting with their dollars, intermediaries and mutual funds would direct their business decisions in light of those approaches finding favor with investors.

III. Completely Rescinding Rule 12b-1

The Proposing Release asks for comments on the concept of eliminating completely Rule 12b-1. Rescinding Rule 12b-1 would negatively impact investors, intermediaries such as Wachovia Securities, and mutual funds. By rescinding the rule, investors would always pay front-end loads when buying through financial intermediaries. Alternatively, they would then be forced to purchase no-load shares on their own by buying directly from the fund. With over half of American households owning mutual funds and with 90% of investors buying their funds through financial intermediaries⁶, the impact of rescinding the rule would be widespread. A large number of investors will be buying front-end load funds as their only option.

While there are NASD rules which impose upper limits on those costs, it is likely that sales loads will drift to the higher end of those caps to recoup the other costs associated with the service intermediaries provide to fund shareholders. Eliminating alternatives for paying for their purchase of fund shares would put mutual fund investors in the unique position of having fewer choices when the concept of providing more options is the growing trend in numerous consumer areas. Front-end loads, no-loads, back-end loads, and level-loads are all appropriate methods under the right circumstances for purchasing mutual fund shares.

Some of the concerns regarding any abuses related to recommending inappropriately certain share classes to investors need additional study, and it may be that

⁶ Brian K. Reid and John D. Rea, "Mutual Fund Distribution Channels and Distribution Costs", ICI *Perspective*, Vol. 9/No. 3, July 2003 at page 5.

there are certain satisfactory alternatives to explore.⁷ Where, however, some studies show that the average holding period for equity mutual funds is 29.5 months,⁸ a “one-size-fits-all” system that would result from the elimination of 12b-1 fees would hurt those investors deciding to hold for relatively short time periods. With the elimination of 12b-1 fees, these investors would pay full front-end loads even though that may not be in the investor’s best financial interest.

The elimination of 12b-1 fees and mutual fund share classes will disadvantaged financial intermediaries. Though there are substantial benefits to investors who seek professional advice, those for whom front-end loads are less workable would simply choose no load funds, thus failing to receive that advice. Losing many of these investors who are appropriate candidates for some of the alternative share classes supported by 12b-1 fees would impact many Wachovia Securities financial advisers who otherwise assist these types of investors. The investors also would lose the counsel and guidance that a financial professional could provide, not just for that mutual fund purchase, but also the wide array of other financial services and products intermediaries like Wachovia Securities offer.

IV. Conclusion

Broadly viewed, 12b-1 fees have greatly assisted in the marketing, distribution and servicing of mutual funds since their adoption by the SEC almost a quarter century ago. Continuing to have the fees paid out of the assets of the fund, with all of the current monitoring mechanisms and safeguards, will benefit investors, funds and financial intermediaries. There is no need to rescind 12b-1 fees altogether. If any action is taken on Rule 12b-1, it should be an effort to modify the rule such that investors retain a wide array of choices to pay for mutual funds, advice and services that will aid them in making financial decisions appropriate to their circumstances.

⁷ One alternative to address breakpoint advantages that flow from Class A shares might be to require funds to offer a proportionate discount across all share classes they sell.

⁸ In a widely quoted 2003 study entitled “Quantitative Analysis of Investor Behavior”, the market research firm Dalbar determined that the average holding period for equity mutual funds is just 29.5 months and that investor holding periods have been declining over time.

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We again appreciate the opportunity to provide these comments and we would be pleased to answer any questions or provide more information to the Commission or the Staff as they work through these important issues.

Very truly yours,

Ronald C. Long

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Wachovia Securities, LLC