

SEC Hosts Roundtable Discussion Regarding Rule 12b-1

On June 19, 2007, the Securities & Exchange Commission ("SEC" or "Commission") hosted a roundtable discussion regarding Rule 12b-1 under the Investment Company Act of 1940 (the "Roundtable").¹ In his opening statement, Chairman Christopher Cox stated that the Commission was taking "serious steps" to evaluate Rule 12b-1.

Andrew Donohue, Director of the Division of Investment Management, in introducing the agenda for the Roundtable, noted the growth of the mutual fund industry between the late 1970s when Rule 12b-1 was first introduced and today. Consistent with prior public statements, Director Donohue stated that one would be "hard pressed to believe that Rule 12b-1 would not benefit from at least a tune-up."² He then mentioned that when Rule 12b-1 was originally adopted, the Commission had stated that it and its staff would monitor the operation of the rule closely and revisit the rule as neces-

sary.³ Director Donohue said that in light of the changes in the mutual fund market and in the role of Rule 12b-1 in fund distribution practices, the Commission is re-examining the rule to evaluate whether it "continues to benefit mutual fund shareholders or whether it would profit from reconsideration." In his view, the Roundtable is one part of the Commission's deliberative process with respect to Rule 12b-1.

Director Donohue indicated that the Commission and the staff are encouraging public comments from all interested parties, not only with respect to the issues discussed at the Roundtable but also as to any other issues relating to the use of fund assets to pay for distribution. Finally, he emphasized that the Rule 12b-1 review is a "top priority" for the Division of Investment Management.

The Roundtable included representatives from the mutual fund industry, related service providers and consumer groups. The four panels, moderated by SEC staff members, addressed:

- the historical circumstances that led to the adoption of Rule 12b-1, and the original intended purpose of the rule;

¹ Additional information about the Roundtable, including public comments, detailed biographies of the participants and the archived webcast, is available at www.sec.gov/spotlight/rule12b-1.htm. It is expected that, once available, a transcript of the Roundtable will also be posted at this address.

² See, e.g., Address to the 2007 Mutual Funds and Investment Management Conference (Mar. 26, 2007), available at www.sec.gov/news/speech/2007/spch041207cc.htm. These statements are also consistent with public statements from Chairman Cox. See, e.g., Address to the Mutual Fund Directors Forum Seventh Annual Policy Conference (Apr. 13, 2007), available at www.sec.gov/news/speech/2007/spch041207cc.htm.

³ See Bearing of Distribution Expenses by Mutual Funds, Release No. IC-11414 (Oct. 28, 1980) ("Rule 12b-1 Adopting Release").

- the evolution of the uses of Rule 12b-1 and the rule's current role in fund distribution practices;
- the costs and benefits of the current use of Rule 12b-1; and
- the options for reform or repeal of Rule 12b-1.

At the end of each panel, the SEC staff moderators asked participants to offer suggestions about how the Commission and/or the staff should proceed in revisiting Rule 12b-1. While the views expressed on each panel were anything but unanimous, several common suggestions were made. Below are examples of areas of agreement among panelists (note, however, that this is not an exhaustive list):

- The Rule 12b-1 Adopting Release provides guidance in the form of a non-exhaustive list of factors that directors should consider when adopting or renewing a Rule 12b-1 plan. Most Roundtable participants agreed, however, that these factors no longer reflect reality with respect to 12b-1 plans and the use of 12b-1 fees throughout the mutual fund industry. As such, most participants suggested that the SEC revisit the factors and either withdraw them entirely or revise and modernize them.
- Panelists were almost uniformly supportive of the 25 basis point service fee adopted by many funds. Many panelists noted that the services that are paid for with these fees could not be paid for more cheaply or efficiently if these fees were charged on an individual shareholder basis. Several panelists also noted that the 25 basis service fee allows smaller complexes to access certain distribution channels and platforms that might not otherwise be available to them. For example, funds many use this fee to pay supermarket platform fees or 401(k) plan consultants.
- Many panelists also highlighted the confusing nature of the name "12b-1 fees" and recommended that the SEC or the staff require better disclosure regarding these fees. Note, however, that the proponents of

improved disclosure did not call for more disclosure, but rather for more transparent and meaningful disclosure. For some panelists, such improved disclosure might include providing information about fees paid in dollar amounts on an individual shareholder basis (even if fees were not charged to shareholders in this manner). For other panelists, it could mean using something other than "12b-1 fees" to identify these fees in shareholder communications.

- Finally, panelists did not call for a wholesale repeal of Rule 12b-1. In fact, most panelists requested that the SEC and its staff carefully analyze the extent to which changes to Rule 12b-1, whether drastic or minor, might have wide-reaching consequences across the fund industry.

The SEC's roundtable afforded participants an opportunity to air many viewpoints regarding Rule 12b-1; however, neither the Commissioners nor the staff provided a clear indication of future action that may be taken with respect to Rule 12b-1. Both Chairman Cox and Director Donohue noted that the Roundtable was the first step in the deliberative process of revising Rule 12b-1.



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