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December 1, 2010

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

Re: Mutual Fund Distribution Fees; Confirmations (File Number S7-15-10)

Dear Ms. Murphy:

This letter and attached economic analysis supplement the Investment Company Institute's¹ comment letter² on the Securities and Exchange Commission's proposed new rule and rule amendments that would replace Rule 12b-1 under the Investment Company Act of 1940.³

As required by statute, the SEC must weigh the anticipated benefits of a rulemaking against any resulting costs and burdens for investment companies generally and small funds in particular. In the ICI Comment Letter, we questioned whether the proposal has met the statutory requirements. Our own economic analysis, which is described fully in the attached paper and summarized briefly below, confirms our initial view that the benefits of this proposal do not outweigh its costs.

Summary of ICI's Economic Analysis

We conducted a detailed survey of 20 ICI member firms, which together offer 1,044 funds that have at least one share class with a 12b-1 fee greater than 25 basis points. Although these 1,044 funds account for only 30 percent of the 3,435 funds that have at least one share class with a 12b-1 fee greater

¹ The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$12.33 trillion and serve over 90 million shareholders.

² See letter from Karrie McMillan, General Counsel, Investment Company Institute to Elizabeth Murphy, Secretary, SEC (November 5, 2010) (the "ICI Comment Letter").

³ *Mutual Fund Distribution Fees; Confirmations*, SEC Release Nos. 33-9128; 34-62544; IC-29367 (July 21, 2010), 75 FR 47064 (August 4, 2010) (the "Release").

than 25 basis points, they represent 64 percent (\$533 billion out of \$838 billion) in total net assets of such classes.⁴

Based on our survey, we estimate that the cost of implementing the rule will be \$418 million initially, more than twice the \$159 million estimated by the SEC. Our higher estimate is due mainly to two factors. First, fund sponsors with share classes greater than 25 basis points expect to modify their share class structures by amending and/or creating share classes (a more costly alternative) at a higher rate than anticipated by the SEC. Second, our cost for these funds to renegotiate their underwriting and dealer agreements is substantially higher than the SEC's estimate.

In addition, we estimate that the annual ongoing costs to funds cumulated over the five-year grandfathering period would conservatively amount to \$345 million, over 8 times the \$40 million that the SEC estimated. The SEC's estimate does not appear to consider additional transfer agent (TA) costs that would be incurred during the five-year grandfathering period by the funds in our survey that indicated they would create new share classes.

On the benefit side, we see little basis for the SEC's estimate that the proposed rule will convey annual benefits to fund shareholders of \$1.1 billion to \$1.3 billion. These estimates are based on the assumption that by capping the asset-based distribution fees investors pay to intermediaries *through* funds, they will pay intermediaries less *overall* yet still receive comparable services. This ignores market realities. The price for services brokers and financial advisers provide is determined by the market and depends on the nature, quality, and quantity of services they provide to investors. Capping fees that investors pay through funds will not change this: if intermediaries cannot receive the market-determined level of compensation through fund related payments (*e.g.*, through 12b-1 fees), they will seek that compensation outside of funds (*e.g.*, through account level charges) or sell products where distribution fees are not capped (*e.g.*, separate accounts). Thus, the SEC's estimates of \$1.1 to \$1.3 billion in savings are best interpreted not as a net benefit to investors but as a reduction in the fees that investors would pay *through* mutual funds matched by a one-for-one dollar increase in fees that they would pay *outside* of funds, in effect doing nothing more than "squeezing a balloon." That does not create a net benefit to investors.

In addition, the SEC's cost-benefit analysis simply does not anticipate or address many significant issues the proposal may create. For example, the SEC's analysis provides little explanation of how the proposal would affect investors in retirement share classes and whether it will benefit them. There is little discussion about the likelihood that the SEC's proposed restructuring of distribution fees

⁴ Our analysis focuses on the costs to funds and the benefit to investors from the proposed changes. We did not attempt to verify the SEC's cost estimates for intermediaries because we do not have access to the data necessary to conduct such an analysis.

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currently paid through funds could price small investors out of the market and whether that outcome would be beneficial. There is no analysis of the possibility that a vast restructuring of the fund distribution system could shift incentives for intermediaries to promote other, less regulated financial products and whether that would be beneficial or costly to investors.

* * * * *

As we said in the ICI Comment Letter, we believe that the proposal is far more extensive and intrusive than necessary. If adopted as proposed, the revisions could fundamentally alter the way intermediaries use funds in various distribution channels, significantly affect the lineup of share class options currently available to investors, necessitate major systems changes, and require the renegotiation of thousands of dealer agreements. All of this would be done at a great cost that would be reflected in higher expenses borne by shareholders. And the benefits are uncertain and quite possibly illusory. As a result, the significant operational and transitional costs on funds, intermediaries, and investors are simply not warranted, and the SEC must take a further and more careful look at its economic analysis before proceeding with this rulemaking.

If you have any questions about this letter, our white paper, or the survey, please contact us at (202) 326-5815 (Ms. McMillan) or (202) 326-5917 (Mr. Reid).

Sincerely,

/s/ Karrie McMillan

/s/ Brian Reid

Karrie McMillan
General Counsel

Brian Reid
Chief Economist

Encl.

cc: The Honorable Mary L. Schapiro
The Honorable Kathleen L. Casey
The Honorable Elisse B. Walter
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Investment Company Institute

Cost-Benefit Analysis of SEC Rule 12b-1 Reform Proposal

December 1, 2010

Cost-Benefit Analysis of SEC Rule 12b-1 Reform Proposal

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Executive Summary

In its proposed revisions to Rule 12b-1, the Securities and Exchange Commission (SEC) would rescind Rule 12b-1 under the Investment Company Act of 1940 and replace it with a new framework for “marketing and service fees” and “ongoing sales charges.”¹ In addition, the proposal would modify the disclosure regime for distribution fees charged through mutual funds, change the role of fund boards in approving distribution fees, and would provide funds with an option to issue shares at net asset value to dealers, who would then be free to establish and collect their own commissions or other sales charges to pay for distribution. In combination, these changes would amount to the most significant revision of the rules governing fund distribution charges since Rule 12b-1 itself was adopted in 1980.

By law, the SEC is required to conduct a robust analysis of the costs and benefits of any proposed rule. To that end, the rule proposal offers a lengthy cost-benefit analysis that concludes that the SEC expects the proposal to cost funds and intermediaries one-time expenditures of \$763 million and annual ongoing expenditures of \$304 million. The bulk of the costs as estimated by SEC are borne primarily by intermediaries. The SEC anticipates costs to funds to be \$159 million initially and \$8 million on an ongoing annual basis.² Set against this, the SEC argues that the rule proposal will result in a number of significant benefits including: (1) protecting individuals from paying disproportionate sales charges in certain share classes; (2) promoting investor understanding of fees; (3) eliminating outdated requirements; (4) providing a more appropriate role for fund directors; and (5) introducing greater competition among funds in setting sales loads and distribution fees. Using various assumptions, the SEC suggests that by providing better information to investors and capping the asset-based distribution fees investors pay to intermediaries through funds, investors will see a very significant annual benefit of \$1.1 billion to \$1.3 billion in fee reductions. Taken at face value, these benefits would seem to outweigh the estimated costs of implementing the rule, thus justifying the rule’s adoption.

ICI has undertaken an independent analysis of the SEC’s cost-benefit study. Our analysis focuses on the costs to funds and the benefit the SEC indicates investors may see from the proposed changes.³ Based on a detailed survey of ICI member firms, we estimate that the cost of implementing the rule will be \$418 million initially, more than twice the \$159 million estimated by the SEC.⁴ Our

¹ *Mutual Fund Distribution Fees; Confirmations*, SEC Release Nos. 33-9128; 34-62544; IC-29367 (July 21, 2010), 75 FR 47064 (August 4, 2010) (the “Release”).

² We refer to costs to funds as including any costs that may be incurred by funds themselves and/or their sponsors.

³ We did not attempt to verify the SEC’s cost estimates for intermediaries because we do not have access to the data necessary to conduct such an analysis.

⁴ We received information from 20 fund complexes, which together offer 1,044 funds that have at least one share class with a 12b-1 fee greater than 25 basis points. Although these 1,044 funds account for only 30 percent of the 3,435 funds that have

higher estimate is due mainly to two factors. First, fund sponsors with share classes greater than 25 basis points expect to modify their share class structures by amending and creating share classes (a more costly alternative) at a higher rate than anticipated by the SEC. Second, our cost for these funds to renegotiate their underwriting and dealer agreements is substantially higher than the SEC's estimate.

In addition, we estimate that the annual ongoing costs to funds cumulated over the five-year grandfathering period would conservatively amount to \$345 million, over 8 times the \$40 million that the SEC estimated. The SEC's estimate does not appear to consider additional transfer agent (TA) costs that would be incurred during the five-year grandfathering period by the funds in our survey that indicated they would create new share classes.

On the benefit side, we see little basis for the SEC's estimate that the proposed rule will convey annual benefits to fund shareholders of \$1.1 billion to \$1.3 billion. These estimates are based on the assumption that by capping the asset-based distribution fees investors pay to intermediaries *through* funds, they will pay intermediaries less *overall* yet still receive comparable services. This ignores market realities. The price for services provided by brokers and financial advisers to investors is determined by the market and depends on the nature, quality, and quantity of services. Capping fees that investors pay through funds will not change this: if intermediaries cannot receive the market-determined level of compensation through fund related payments (*e.g.*, through 12b-1 fees), they will seek that compensation outside of funds (*e.g.*, through account level charges) or sell products where distribution fees are not capped (*e.g.*, separate accounts).

Thus, as we discuss, the SEC's estimates of \$1.1 to \$1.3 billion in savings are best interpreted not as a net benefit to investors but as a reduction in the fees that investors would pay *through* mutual funds matched by a one-for-one dollar increase in fees that they would pay *outside* of funds, in effect doing nothing more than "squeezing a balloon," which does not create a net benefit to investors.

Furthermore, the SEC's analysis of benefits simply does not anticipate or address many significant issues the proposal may create. For example, the SEC provides little analysis of how the proposal would affect investors in retirement ("R") share classes and whether it will benefit them. There is also little, if any, analysis of the possibility that a vast restructuring of the fund distribution system could shift incentives for intermediaries to promote other financial products and whether that would be beneficial or costly to investors.

In sum, we find no reasonable basis on which to conclude, as the SEC does, that the benefits of this rule proposal outweigh its costs. If adopted as proposed, the revisions could fundamentally alter

at least one share class with a 12b-1 fee greater than 25 basis points, they represent 64 percent (\$533 billion out of \$838 billion) in total net assets of such classes.

the way intermediaries use funds in various distribution channels, significantly affect the lineup of share class options currently available to investors, necessitate major systems changes, and require the renegotiation of thousands of dealer agreements. All of this would be done at a great cost that would be reflected in higher expenses borne by shareholders. And the benefits are uncertain and quite possibly illusory. As a result, the significant operational and transitional costs on funds, intermediaries, and investors are simply not warranted.

Cost-Benefit Analysis of SEC Rule 12b-1 Reform Proposal

The discussion below is in four parts. The first section provides a brief summary of the proposed requirements. The second section describes the survey the Institute conducted to gather information on the SEC's proposal. The third section provides detailed information on our estimates of the costs of the proposed changes and how they compare to the SEC's estimates. The fourth section evaluates the methodology and assumptions used by the SEC in their calculation of the benefits from the proposal.

1. Summary of Proposed Requirements

The proposed rule (Rule 12b-2) and rule amendments would replace Rule 12b-1 under the Investment Company Act. Rule 12b-1 and its associated fees allow investors to pay distribution costs over time, to access funds that might not otherwise be available to them, and to compensate financial intermediaries, on whom so many investors depend. The new rule and amendments would allow funds to continue to bear distribution costs and retain the ability of funds to provide investors with alternatives for paying sales charges, but would impose a new structure for distribution fees and new limitations on distribution fees. The proposed requirements also would mandate changes to fund disclosure documents and shareholder transaction confirmations and quarterly statements.

1.1 Marketing and Service Fee and Ongoing Sales Charge

The primary feature of the proposal is that it separates the current 12b-1 fee into two components: a marketing and service fee and an ongoing sales charge. Under the proposed requirements, any class of fund shares would be permitted to deduct a marketing and service fee of up to the NASD service fee limit (currently 25 basis points) from fund assets to pay for distribution-related activities. Proposed amendments to Rule 6c-10 would permit funds to deduct asset-based distribution fees in excess of the marketing and service fee cap of 25 basis points, provided the additional amount is considered an ongoing sales charge. Share classes with an ongoing sales charge could comply with the proposed requirements by having an automatic conversion feature such that shares with respect to which the cumulative sales charge reaches a limit or reference load would convert to a share class that has a 25 basis point marketing and service fee with no ongoing sales charge.⁵ This is widely viewed as the easiest way to comply with the requirement that the cumulative ongoing sales charge cannot exceed the reference rate.

⁵ Proposed Rule 6c-10(b) would limit ongoing sales charges to an amount or rate in basis points not to exceed the amount or rate in basis points of the highest front-end load that the investor would have paid if she had invested in another class of shares in the same fund. In some cases, the highest front-end load may be set by the maximum sales charge limit of 6.25% from NASD Conduct Rule 2830(d)(2)(a).

All funds that currently have 12b-1 fees would be affected by this aspect of the proposal. The degree to which the funds are impacted depends on the current level of their 12b-1 fees. Those funds with 12b-1 fees that are 25 basis points or less would be less affected as they could more easily transition from a 12b-1 fee of a specific amount to a marketing and service fee of the same amount with no ongoing sales charge. Funds that have share classes with a 12b-1 fee greater than 25 basis points would be impacted the most. These funds would first have to pare off the 25 basis point marketing and service fee, and then consider their options for the amount above the marketing and service fee cap. The funds would have to determine how to adjust to the new rules based on their investors and their current distribution arrangements.

As outlined in the proposal, funds and their sponsors have three major ways in which to modify share classes that have a 12b-1 fee greater than 25 basis points to be in compliance with the proposed requirements. For any share class with a 12b-1 fee greater than 25 basis points, the fund can (1) reduce the current 12b-1 fee to the marketing and service fee cap, (2) restructure the 12b-1 fee to reclassify any non-distribution related expenses as operating expenses, or (3) amend and/or create share classes to have an ongoing sales charge. Fund sponsors may employ one or more of these options across the affected share classes. For example, for one share class, the fund sponsor may decide to reduce the 12b-1 fee to the marketing and service fee cap. For another share class in the same fund family, the fund sponsor may decide to amend the share class and implement an ongoing sales charge.

The options to either “Reduce Fees” or “Restructure Fees” generally are operationally easier to implement than the third option, which entails amending current share classes and/or creating new share classes to have an ongoing sales charge. If the fund chooses the third option (“Amend and/or Create”), the SEC describes four potential routes that it believes fund complexes could use to come into compliance with the proposal: (1) retaining existing share class structures and conversion systems; (2) updating the fund complex’s existing conversion system and amending the class structure; (3) updating the complex’s existing conversion system, amending the class structure, and creating new share classes; and (4) creating/purchasing a new conversion system, amending the class structure, and creating new share classes. The routes are described below.

- *Route 1: Retain Existing Share Class Structure and Conversion Systems.* The SEC suggests that a complex that sells funds with an existing class structure that already generally complies with the proposal might only need to make minor changes to its operations in response to the proposal. For example, a complex that does not sell C shares, sells B shares that convert at a time that is consistent with proposed rule 6c-10(b), and has a target class for converted shares (*i.e.*, a class that deducts 25 basis points or less in asset-based distribution fees), would be included in this category. This route is widely expected to have minimal costs associated with it.

Route 2: Update Conversion System and Make Amendments to Class Structure. Some funds might be able to comply with the proposal by making amendments to their existing share classes, without needing to create new share classes. For example, funds may need to change the conversion period of their class B shares, institute a conversion period for class C shares, or make other changes to their class structure. The SEC refers to this as “Route 2.” The SEC assumes that complexes that choose this route would not need to create new share classes, because they would already have a target class for conversions that meets the requirements of proposed rule 6c-10(b) (e.g., an existing share class with 12b-1 fees of 25 basis points or less). This route is widely expected to have more costs associated with it than the options to “Reduce Fees” or “Restructure Fees” and “Route 1.”

- *Route 3: Update Conversion System, Make Significant Changes to Class Structure, and Create New Share Classes.* Some complexes may need to create new share classes to comply with the proposal. For example, complexes might need to create new share classes either because they do not have an appropriate target class for conversions (e.g., if their class A shares deduct more than 25 basis points in asset-based distribution fees), or if they chose to maintain grandfathered 12b-1 assets in existing share classes and create new share classes for all future share purchases after the compliance date. The SEC assumes that, in addition to creating new share classes, these complexes would also likely need to amend their existing share classes and update their conversion systems. The SEC refers to this as “Route 3.” This route is widely expected to have more costs associated with it than “Route 2.”
- *Route 4: Purchase New Conversion System, Make Significant Changes to Class Structure, and Create New Share Classes.* Some funds may choose to purchase or create a conversion system, either because they only sell a single class of shares, or if they sell multiple classes of shares, none of their share classes has a conversion feature. These fund families would also need to create a new target class for converted shares, amend existing share classes, and if the fund chose to maintain grandfathered 12b-1 assets in the existing class, create a second class of shares for future purchases. The SEC refers to this as “Route 4.” This route is widely expected to be the most expensive.

In addition, the SEC would provide for a five-year grandfathering period for share classes that deduct 12b-1 fees and were issued prior to the compliance date. At the end of the five-year period, these grandfathered shares would be required to be converted or exchanged into a class that does not deduct an ongoing sales charge.

1.2 Amendments to Disclosure Documents

Several amendments in the proposal would require funds with 12b-1 fees, regardless of the amount of the distribution fee, to make changes to various disclosure documents.⁶ One of the requirements would necessitate changes to the fee table on Form N-1A in order to show the two components of asset-based distribution fees: the “Marketing and Service Fee” and the “Ongoing Sales Charge.” All funds with 12b-1 fees will need to make this change, which is expected to account for the bulk of the time spent on revisions to disclosure documents.

1.3 Amendments to Rule 10b-10 for Confirmations and Quarterly Statements

The proposal includes a number of new disclosure requirements in investor confirmation statements (“confirms”) under Rule 10b-10. Under the proposal, confirms would be required to include the amount of any sales charge that the customer incurred at the time, in percentage and dollar terms, along with the net dollar amount invested and the amount of any applicable breakpoint or similar threshold used to calculate the sales charge. In addition, confirms would have to include, if applicable: the annual amount of any marketing and service fee; the annual amount of any ongoing sales charge; the aggregate amount of the ongoing sales charge that may be incurred over time, expressed as a percentage of net asset value; and the maximum number of months or years that the customer will incur the ongoing sales charge. Confirms would also have to include a standardized statement warning investors that there are additional asset-based fees and other expenses explained in the fund’s prospectus. These changes would seem to affect virtually all funds that send out confirms, not just those with ongoing sales charges. For example, any fund with a marketing and service fee regardless of whether it has an ongoing sales charge would have to have the standard disclaimer. Also, as a practical matter, mutual fund transfer agents would likely program to consistently apply such changes to all investor confirmations and quarterly statements.

⁶ The proposed requirements would require changes to Form N-1A, the prospectus, the Statement of Additional Information, Form N-SAR, Forms N-3, N-4, and N-6, Regulation S-X, and streamlined proxy procedure.

2. Survey Description

In the proposing release, the SEC conducted a cost-benefit analysis and requested comment on various aspects of its review. The SEC made assumptions regarding how fund sponsors would modify share class structures to be in compliance. More specifically, the SEC predicted how many share classes with 12b-1 fees greater than 25 basis points would reduce or restructure their distribution fees or amend and/or create share classes with an ongoing sales charge and how much time and money would be spent on each of these options. The SEC also estimated time and dollar costs of the proposed disclosure requirements. The SEC asked for feedback on these assumptions and estimates and invited comment on any costs or benefits omitted in their study.

In response to this request for information, the Institute surveyed fund sponsors that would be most affected by the proposal (*i.e.*, those with share classes that have a 12b-1 fee of greater than 25 basis points). The questionnaire requested information in four general areas related to the proposal: (1) options to reduce fees, restructure fees, or amend, and/or create share classes; (2) renegotiations of underwriting and dealer agreements; (3) revisions to disclosure documents; and (4) revisions to Rule 10b-10 confirmations and quarterly statements.⁷

We received information from 20 complexes, which together offer 1,044 funds that have at least one share class with a 12b-1 fee greater than 25 basis points. Although these 1,044 funds account for only 30 percent of the 3,435 funds that have at least one share class with a 12b-1 fee greater than 25 basis points, they represent 64 percent (\$533 billion out of \$838 billion) in total net assets of such share classes. All but one of the complexes provided estimates on the number of hours necessary to comply with the proposed changes on an initial basis. All of the complexes provided estimates of initial dollar costs. Complexes to varying degrees provided information on hours and dollar costs necessary to comply with the proposed changes on an ongoing basis. We also received cost data on systems programming and confirmations from the three largest external mutual fund transfer agent service providers to the industry to assist in our analysis.

3. Estimated Costs of Proposed Changes

To implement the proposed requirements, fund sponsors would need to make several critical changes to their funds. First, virtually all mutual fund transfer agents that provide quarterly statements and confirmations to accounts held directly at funds would need to make changes to these documents. Second, all fund sponsors offering funds with 12b-1 fees will need to make changes to disclosure documents. Third, sponsors offering share classes with 12b-1 fees greater than 25 basis points will need to make important decisions about whether to reduce fees, restructure fees, or amend and/or create

⁷ The questionnaire, attached as an appendix, followed closely the outline of the proposal in the SEC release.

share classes with ongoing sales charges. These sponsors will also have to change underwriting and dealer agreements for such share classes. We estimate that 78 percent of funds with 12b-1 fees will face these decisions.⁸

Funds offering share classes that have 12b-1 fees greater than 25 basis points will be the most affected by the proposal and are bound to bear the greatest costs. In this section, we turn first to these funds and discuss the initial and ongoing costs that they are expected to incur based on their choices (“Reduce Fees,” “Restructure Fees,” “Amend and/or Create”) and the associated changes to their agreements. The next section describes the costs related to the proposed disclosure changes that all funds with 12b-1 fees will incur. Finally, the last section provides estimates of the costs that funds will incur by complying with the new confirmation and quarterly statement changes proposed in Rule 10b-10.

In summary, we find that total initial cost to funds from these proposed changes is \$418 million, more than twice the \$159 million estimated by the SEC. In addition, we estimate that cumulative annual ongoing costs over the five-year grandfathering period could conservatively amount to \$345 million, over 8 times the \$40 million that the SEC estimated. The SEC’s estimate does not appear to consider additional transfer agent (TA) costs that would be incurred during the five-year grandfathering period by those funds in our survey that indicated they would create new share classes.

3.1 Estimated Costs for Funds to Modify Share Class Structures and Renegotiate Distribution Agreements

The proposed amendments to Rule 6c-10 would permit funds to deduct asset-based distribution fees in excess of the marketing and service fee in the form of an ongoing sales charge up to a reference load. Funds with share classes that have a 12b-1 fee in excess of 25 basis points will be required to alter these share classes to conform to the proposed rule. Based on our survey, we estimate the initial cost will be \$333 million (\$231 million to modify the share class structure for these funds and \$102 million to renegotiate underwriting agreements and dealer and other third party contracts), well above the SEC’s estimate of \$133 million for total initial costs to funds. This difference is attributable to the higher propensity of ICI respondents to modify their share class structure by amending and creating share classes, a relatively more expensive route, than anticipated by the SEC and a substantially higher ICI estimate for renegotiating distribution contracts than assumed by the SEC.⁹

⁸ As of year-end 2009, we estimate that there were 4,400 funds that charged 12b-1 fees. Of these 4,400 funds, we estimate that there were 3,435 funds that had at least one share class with a 12b-1 fee greater than 25 basis points.

⁹ Intermediaries likely will experience similar additional costs to modify their operations to accommodate new share structures as well as to renegotiate distribution agreements.

In addition, we believe the SEC substantially underestimated annual ongoing costs to funds that choose to create new share classes. In its analysis, the SEC estimated a total of \$10 million in costs each year for funds that opt to amend and/or create share classes. This estimate does not appear to consider additional transfer agent (TA) costs that would be incurred during the five-year grandfathering period by those funds that create new share classes. Eleven complexes in our survey indicated that they would create new share classes for some of their funds. Even under conservative assumptions, these 11 complexes will have spent an estimated \$265 million in additional TA costs, over the five-year grandfathering period, substantially larger than the \$50 million in ongoing costs estimated by the SEC.

The remainder of this section provides more detail on how we arrived at our estimates for funds with 12b-1 fees greater than 25 basis points to modify their share class structures and renegotiate their underwriting, dealer, and other third party agreements.

3.1.1 Estimated Initial Cost for Funds to Modify Share Class Structures

As noted above, funds with a share class that has a 12b-1 fee greater than 25 basis points have three major options for compliance with proposed rule 6c-10. The fund can (1) reduce the current 12b-1 fee on the share class to the marketing and service cap, (2) restructure the 12b-1 fee on the share class to reclassify any non-distribution related expenses as operating expenses, or (3) amend the share class and/or create a new share class.

In our survey, we asked fund complexes to indicate all the major options they would expect at this point to utilize. If the fund complex selected the “Amend and/or Create” option, we also asked them to designate the likelihood of Routes 1 through 4 being undertaken by the complex.¹⁰ Figure 1 summarizes the results from our survey and compares them to the expectations by the SEC.

Fee Reductions: ICI respondents are less inclined to reduce the distribution fee to the 25 basis point cap on a share class that has a 12b-1 fee of more than 25 basis points up to and including 30 basis points than expected by the SEC. The SEC anticipated 40 percent (188 of the 471) of share classes in this 12b-1 fee range would have the distribution fee reduced. In our sample, we found only 22 percent (45 of the 205) of such share classes likely would have the distribution fee reduced. A few respondents indicated that fee reduction was not an economically viable option for them.

¹⁰ For a discussion of the four possible routes suggested by the SEC, see pages 2 – 3 above. We asked fund complexes to assign the likelihood of each route as either “Definitely,” “Most Likely,” “Somewhat Likely,” “Unlikely,” or “Not at all.” Complexes that marked any route as “Definitely” or “Most Likely” were designated as selecting that route. Complexes that did not have any route marked as “Definitely” or “Most Likely,” but had any route selected as “Somewhat Likely” were designated as selecting that route. Complexes could be designated as selecting more than one route as a particular route may be appropriate for one fund and a different route more appropriate for another fund.

Fee Restructuring: ICI respondents are more reluctant to restructure their 12b-1 fees by reclassifying all or some of the amount in excess of the cap as an operating expense on share classes with 12b-1 fees of more than 25 basis points up to and including 50 basis points. The SEC anticipated that half of share classes (990 out of 1980) in this 12b-1 fee range (excluding those it anticipated to carry out fee reductions) would select this option. In our sample, we found only 21 percent (178 out of 841) of such share classes likely would be restructured in this manner.

Amend and/or Create Share Classes: Based on the responses to our survey, we expect about 75 percent of share classes with a 12b-1 fee of more than 25 basis points up to and including 50 basis points would be modified to include an ongoing sales charge.¹¹ Consistent with the SEC's expectation, we anticipate that all share classes with a 12b-1 fee greater than 50 basis points also would be modified to include an ongoing sales charge. In order to capture economies of scale from systems and programming changes, the SEC estimated the percentage of fund complexes that would select each route. To maintain comparability with the SEC's estimates, we calculated the percentage of fund complexes that said they were likely to opt for each route. A complex could select more than one route.

Route 1: Seventeen percent of fund complexes in our sample indicated that they were likely to retain their existing share class structure and conversion system, close to the 14 percent expected by the SEC.

Route 2: ICI respondents are less likely to only amend their existing share class structure and update their conversion system than anticipated by the SEC. The SEC expected 45 percent of fund complexes to choose this option as compared to 28 percent of respondents in our sample.

Route 3: ICI respondents are more likely to do a combination of amending their existing share class structure, creating new share classes, and updating their conversion system than anticipated by the SEC. The SEC expected 31 percent of complexes to choose this option; whereas, our survey indicates that 61 percent of respondents are likely to select this option.

Route 4: None of the ICI respondents indicated that they would need to create or purchase a new conversion system in addition to amending their existing share class structure, creating new share classes. The SEC expected 10 percent of fund complexes to be in this situation.

¹¹ Calculated as $[(\# \text{ of share classes with } 25 \text{ basis points} < 12\text{b-1 fee} \leq 50 \text{ basis points} = 2,168) - (\# \text{ of share classes with } 25 \text{ basis points} < 12\text{b-1 fee} \leq 30 \text{ basis points that will reduce fees} = 104) - (\# \text{ of share classes with } 25 \text{ basis points} < 12\text{b-1 fee} \leq 50 \text{ basis points that will restructure fees} = 433)] / (\# \text{ of share classes with } 25 \text{ basis points} < 12\text{b-1 fee} \leq 50 \text{ basis points} = 2,168)$. Number of share classes with 25 basis points < 12b-1 fee ≤ 30 basis points that will reduce fees = $.22 \times 471 = 104$. Number of share classes with 25 basis points < 12b-1 fee ≤ 50 basis points that will restructure fees = $.21 \times (2,168 - 104) = 433$.

Figure 1
Propensity to Select Options to Modify Share Class Structure
Percent

	Reduce Fees ¹	Restructure Fees ²	Amend and/or Create Share Classes ³			
			Route 1	Route 2	Route 3	Route 4
ICI respondents	22%	21%	17%	28%	61%	0%
SEC	40%	50%	14%	45%	31%	10%

1. Expressed as a percentage of the number of share classes with 12b-1 fees of more than 25 basis points up to and including 30 basis points. Of the 205 share classes with 12b-1 fees in this range in our sample, respondents indicated that for 45 share classes (22%), they would be most likely to reduce the fee to the proposed marketing and service fee cap of 25 basis points.

2. Expressed as a percentage of the number of share classes with 12b-1 fees of more than 25 basis points up to and including 50 basis points; less those share classes expected to reduce the fee to proposed marketing and service fee cap of 25 basis points. Of the 841 share classes (886 total less 45 expected to reduce the fee) with 12b-1 fees in this range in our sample, respondents indicated that for 178 share classes (21%), they would attempt to re-classify all or some of the amount in excess of 25 basis points as an operating expense.

3. Expressed as a percentage of complexes with 12b-1 fees of more than 25 basis points. ICI respondents' percentages add to more than 100 percent across all four routes as the options may not be mutually exclusive within a complex. For example, depending on its share class structure, a complex may choose "Route 1" for one fund and "Route 3" for another fund. The SEC percentages differ from that reported in the SEC release. The estimated number of fund families (we interpret this as complexes) selecting each route remains the same as in the SEC release. These totals, however, have been scaled by 207 (Release at p. 47110), which is the number of fund complexes that may be affected by the proposed amendments to Rule 6c-10. This rescaling was necessary to obtain the SEC's estimate of the percentage of fund complexes it anticipated selecting "Route 4."

The Institute's survey asked fund complexes to estimate costs for modifying its share class structure. We requested information on time and dollar costs spent by staff in legal (both internal and external), fund operations, fund administration (including accounting), and distribution, as well as time spent educating and training staff and communicating and coordinating modifications with intermediaries in the distribution channels. We also requested cost information for new systems requirements and related programming.¹² We did not collect costs separately for each option or route, but rather we collected aggregate cost estimates from each complex in order to capture any economies of scale for those complexes that would be likely to implement more than one major option and/or route. Fund complexes that indicated a combination of less costly and more costly alternatives would have proportionately lower costs than a complex that indicated the sole use of a more costly route. These lower anticipated costs are reflected in the overall average and the averages split by size of

¹² Complexes that select "Route 2," "Route 3," or "Route 4" would likely need to update or implement conversion/aging systems, share lot transfer systems, and comply with the proposed amendments to rule 11a-3, which would require funds to give shareholders "credit" against the rate of any sales load owed for ongoing sale charges paid by investors who exchange fund shares within a fund group. Complexes that use an external transfer agent (TA) service provider did not report any systems or programming costs on their surveys. We separately collected a cost estimate from three major mutual fund TA service providers for expected systems and programming changes and we expect that these costs will be passed on to funds.

complex. ICI respondents indicated that it would cost \$70,100 per fund to implement the changes, about 80 percent higher than the implicit \$38,800 per fund as estimated by the SEC.¹³

Figure 2
Estimated Initial Monetary Cost to Modifying Share Class Structure
Dollars per fund

	SEC ¹	ICI Respondents ²
Initial compliance	\$38,800	\$70,100

1. Calculated as \$15.7 million (estimated cost for fee restructuring) + \$1.3 million (estimated cost for “Route 1”) + \$27.7 million (estimated cost for “Route 2”) + \$73 million (estimated cost for “Route 3”) + \$26.7 million (estimated cost for “Route 4”) less \$11.2 million (estimated cost saving from no longer tracking FINRA caps) = \$133.2 million (SEC estimated total cost). Dollars per fund calculated as \$133.2 million/3,435 (# of funds with 12b-1 fees greater than 25 basis points) = \$38,777 (rounded to \$38,800).

2. Calculated as \$73.2 million (total estimated costs from ICI respondents)/1,044 (# of funds with 12b-1 fees greater than 25 basis points in our sample) = \$70,115 (rounded to \$70,100).

We investigated whether there was a significant difference in per fund costs by complex size because we were concerned with overestimating aggregate fund costs from applying the \$70,100 per fund estimate to all 3,435 funds with 12b-1 fees greater than 25 basis points. As shown in Figure 3, per fund costs at smaller complexes are substantially lower (\$20,600) than those for larger fund complexes (\$75,100). This is not surprising as some larger complexes support proprietary systems, others highly customized systems. Larger complexes also have more extensive distribution networks (more arrangements), support more funds/classes and customer accounts, and have a more diverse customer base.

Figure 3
Estimated Initial Monetary Cost to Modifying Share Class Structure by Complex Size for ICI Respondents
Dollars per fund

	Smaller Complexes ¹	Larger Complexes ²
Initial compliance	\$20,600	\$75,100

1. Smaller complexes are defined as those with \$10 billion or less in long-term mutual fund assets.

2. Larger complexes are defined as those with more than \$10 billion in long-term mutual fund assets.

¹³ The SEC release did not report their cost estimates on a per fund basis. We were able to derive one based on the aggregate cost information provided in the release. See Figure 2, footnote 1 for details.

Overall, we estimate that funds with 12b-1 fees greater than 25 basis points and their sponsors will spend \$231 million (Figure 4) initially to implement changes to their share classes in order to comply with rule 6c-10(b). This estimate is \$98 million higher than the SEC’s estimate. Some of this difference likely reflects the higher propensity in our survey for fund complexes to opt for “Route 3” (both creating and amending share classes), which is more costly than “Route 2” (only amending share classes). For example, complexes may need to create a “Class A2” share class for conversion to use as a target class if they do not have an existing Class A share with a 12b-1 fee of 25 basis points or less. Complexes may also want to create a new “Class C2” share that complies with the proposed requirements because of existing distribution arrangements. This would address any concerns that investors may be confused by having grandfathered shares and new shares converting on different schedules within the same share class (an implication of using “Route 2”). There may also be other legal, fund accounting, operations, and distribution-related issues—some of which may be driven by marketplace demand—that would make creating new share classes the more appropriate alternative.

Figure 4
Estimated Initial Monetary Cost to Modifying Share Class Structure
Millions of dollars

	SEC ¹	ICI Respondents ²
Initial compliance	\$133	\$231

1. Calculated as (# of funds with 12b-1 fees greater than 25 basis points = 3,435) x (cost per fund from Figure 2 = \$38,800).
2. Calculated as (# of funds with 12b-1 fees greater than 25 basis points at larger fund complexes = 2,879) x (cost per fund from Figure 3 = \$75,100) + (# of funds with 12b-1 fees greater than 25 basis points at smaller fund complexes = 556) x (cost per fund from Figure 3 = \$20,600) + \$3.5 million in additional systems programming costs that would be incurred by three external mutual fund transfer agents service providers.

3.1.2 Estimated Ongoing Cost for Funds to Modify Share Class Structures

In addition to the initial costs of modifying fund share class structures, funds will incur ongoing costs as well. We believe the SEC substantially underestimated annual ongoing costs to funds that choose to amend and create new share classes. In its analysis, the SEC estimated a total of \$10 million in costs each year for funds that opt to amend and/or create share classes under “Route 2,” “Route 3,” and “Route 4.” This estimate does not appear to consider the additional transfer agent (TA) costs that would be incurred under Route 3 and Route 4 during the five-year grandfathering period.

Under “Route 3” and “Route 4,” funds would close Class A shares with a 12b-1 fee greater than 25 basis points and Class C shares to new sales and grandfather the assets in current shareholder accounts. The fund would then create new Class A shares (Class A2) and Class C shares (Class C2) that are in compliance with the proposed requirements for new purchases by new shareholders and subsequent purchases by current shareholders. Current shareholders that make subsequent purchases

of the fund would have two accounts; one for their assets in their grandfathered Class A or Class C shares and one for their purchases of the new Class A2 or Class C2 shares.

Creating new share classes that will need to be utilized by current shareholders for subsequent purchases to comply with the requirements of the proposal will translate into a doubling in the number of accounts held by those shareholders during the grandfathering period. Figure 5 demonstrates an example of these additional accounts. Based on our survey, 11 complexes indicated that they would be likely to create new Class A and Class C shares. These complexes have a total of 17 million shareholder accounts in these classes—5.3 million in Class A shares and 11.7 million in Class C shares.¹⁴ We have assumed that share classes representing only half of the 17 million accounts (8.5 million accounts) would create new A2 and C2 shares. Also, we have assumed in each of the first five years after the traditional A and C share classes are closed, ten percent of the 8.5 million current shareholders will have a subsequent purchase necessitating the opening of a new Class A2 or Class C2 account. At the end of the fifth year, half of the 8.5 million shareholder accounts would have had a subsequent purchase resulting in 4.25 million additional accounts.

Because new share classes will be created and new accounts will be established to support existing shareholders that will subsequently purchase shares, additional transfer agent costs to the fund during the five-year grandfathering period can quickly mount up even under conservative assumptions. Based on data from a recent Institute study on mutual fund transfer agent fees, we estimate the blended annual average TA per account charge to be \$20.80. This figure represents the blended average TA per account charge for open accounts of equity funds that use either an external or internal TA and includes payments to third parties for TA servicing and TA-related out-of-pocket charges. In our example, 850,000 new accounts would be created in the first year due to subsequent purchases by current shareholders. These new accounts would cost the funds close to \$18 million in the first year. As more grandfathered shareholders make subsequent purchases into the new share classes in ensuing years, more new accounts are established thus further increasing annual TA costs. By the end of the five-year grandfathering period, just these 11 complexes will have incurred an estimated \$265 million in additional TA expenses (Figure 5). This is substantially larger than the \$50 million in ongoing costs the SEC estimated over the five-year grandfathering period.

¹⁴ Based on data submitted by our members, we estimate that there are 30.1 million accounts in Class A (10 million) and Class C (20.1 million) shares. These figures should be interpreted as a minimum because they include omnibus accounts which are recorded as one account but can represent thousands of underlying accounts.

Figure 5
Projection of Ongoing Transfer Agent Costs Over five-year Grandfathering Period for ICI Respondents Creating New Share Classes

	Class A2 ¹		Class C2 ¹		Total	
	Accounts ² (thousands)	TA costs ³ (\$millions)	Accounts ² (thousands)	TA costs ³ (\$millions)	Accounts (thousands)	TA costs ⁴ (\$millions)
Year 1	265	\$5.5	585	\$12.2	850	\$17.7
Year 2	530	\$11.0	1,170	\$24.3	1,700	\$35.3
Year 3	795	\$16.5	1,755	\$36.5	2,550	\$53.0
Year 4	1,060	\$22.0	2,340	\$48.7	3,400	\$70.7
Year 5	1,325	\$27.6	2,925	\$60.8	4,250	\$88.4
Total ⁵	1,325	\$82.6	2,925	\$182.5	4,250	\$265.1

1. Current Class A shares with a 12b-1 fee greater than 25 basis points and Class C shares will be closed. The fund will create additional share classes, "Class A2" and "Class C2" that are in compliance with the proposed requirements for purchases by new shareholders and subsequent purchases by current shareholders.

2. This represents the additional accounts that would need to be created to accommodate current shareholders' subsequent purchases of Class A2 and Class C2 shares. As of June 30, 2010, there were a total of 17 million accounts in Class A shares with a 12b-1 greater than 25 basis points (5.3 million accounts) and in Class C shares (11.7 million accounts) at the complexes in our sample that indicated they would be likely to create new share classes. These figures should be interpreted as a minimum because they include omnibus accounts which are recorded as one account but can represent thousands of underlying accounts. We have assumed that share classes representing only half of the 17 million accounts (8.5 million accounts) would create new A2 and C2 shares. Also, we have assumed in each of the first five years after the traditional A and C share classes are closed to new purchases, ten percent of the 8.5 million shareholder accounts would have a subsequent purchase necessitating the opening of a new Class A2 or Class C2 account. At the end of the fifth year, half of the 8.5 million shareholder accounts would have had a subsequent purchase.

3. The annual transfer agent per account charge is estimated to be \$20.80. This figure is the blended average transfer agent per account charge for open accounts of equity funds that use either an external or internal TA and includes payments to third parties for TA servicing and TA-related out-of-pocket charges. Mutual Fund Transfer Agents Trends and Billing Practices, 2009; Investment Company Institute, at 5.

4. Sum of transfer agent costs for Class A2 and Class C2 accounts opened due to subsequent purchases by current shareholders.

5. Sum of transfer agent costs over the five-year grandfathering period. At the end of the five-year grandfathering period, the shareholder's two accounts (e.g., Class A and Class A2) will collapse into one account and ongoing TA costs due to the proposal will be eliminated.

3.1.3 Additional Cost to Renegotiate Distribution Agreements

Funds that have 12b-1 fees in excess of 25 basis points will need to renegotiate distribution and underwriting agreements in addition to the costs discussed above. We believe the SEC significantly underestimated initial costs associated with rewriting underwriting agreements and dealer and other third party contracts.¹⁵ All of these contracts would need to be reviewed, renegotiated, and revised to reflect the new share class structure of the firm. Many fund complexes have large distribution networks that encompass hundreds of distribution and service agreements that will require changes if the proposal is adopted. Based on feedback from our members, we have learned that contract changes can be time-consuming endeavors, particularly for internal legal departments and back office personnel that support distribution arrangements at fund complexes. In addition, underwriting and dealer agreements are not renewed annually so there is no set process in place each year to amend these distribution agreements. Generally, underwriting agreements and dealer contracts are renegotiated every few years or on an as-needed basis. Taking this into consideration, we inquired about hours and dollar costs linked to renegotiating contracts separately from the costs related to the modification of the share class structure detailed above.

Overall, ICI respondents indicated it would take an average of 84 hours of internal and external legal time per fund to renegotiate all their distribution contracts (Figure 6). Nearly all of these hours are coming from the renegotiation of the dealer and other third party contracts. Some funds, particularly those at larger fund complexes, can have hundreds of dealer agreements that would be required to be amended. As shown in Figure 7, ICI respondents at larger fund complexes indicated that it would take an average of 87 hours per fund to complete the renegotiation of their dealer agreements. For smaller fund complexes with fewer arrangements, this estimate was substantially lower at an average of 23 hours.

Figure 6
Estimated Initial Time Burden of Renegotiating Distribution Agreements
Number of hours per fund

	SEC ¹	ICI Respondents
Total	-	84
Underwriting agreements	-	2
Dealer and other third party agreements	-	82

1. The SEC did not show costs for renegotiating contracts separately. These costs are included in the SEC's estimates in Figure 4.

¹⁵ The SEC did not show separately the costs of renegotiating the contracts, but rather included them in its \$133 million overall cost estimate for modifying funds' share class structures.

Figure 7
Estimated ICI Initial Time Burden of Renegotiating Contracts by Complex Size
Number of hours per fund

	Smaller Complexes ¹	Larger Complexes ²
Total	29	89
Underwriting agreements	6	2
Dealer and other third party agreements	23	87

1. Smaller complexes are defined as those with \$10 billion or less in long-term mutual fund assets.

2. Larger complexes are defined as those with more than \$10 billion in long-term mutual fund assets.

We estimate a total cost of \$102 million for funds that would need to renegotiate their underwriting, dealer, and other third party agreements. This estimate is based on the hours spent by smaller and larger complexes as well as a blended hourly rate of \$375 for internal and external legal time.¹⁶

Figure 8
Estimated Initial Monetary Costs of Renegotiating Contracts
Millions of dollars

	SEC ¹	ICI ²
Total	-	\$102
Underwriting agreements	-	\$3
Dealer and other third party agreements	-	\$99

1. The SEC did not show costs for renegotiating contracts separately. These costs are included in the SEC's estimates in Figure 4.

2. Calculated as (# of funds with 12b-1 fees greater than 25 basis points at larger fund complexes = 2,879) x (# of hours from Figure 7) x (hourly rate = \$375) + (# of funds with 12b-1 fees greater than 25 basis points at smaller fund complexes = 556) x (# of hours from Figure 7) x (hourly rate = \$375).

¹⁶ ICI respondents provided both hours and dollar costs for internal and external legal time. The \$375 blended hourly rate is the sum of the dollar costs divided by the sum of the hours across all respondents.

3.2 Disclosure Costs for All Funds with Share Classes with a 12b-1 Fee

Under the proposed rule changes, all funds with 12b-1 fees will be required to make changes to their disclosure documents. Most of the burden from the proposed changes focuses on changes to Form N-1A. Overall, ICI respondents indicated that the disclosure changes would take an average of 31 hours of legal time per fund (Figure 9), significantly higher than the 10 hours estimated by the SEC. Again, there was a difference between smaller and larger complexes for ICI respondents, with smaller complexes indicating an average time burden of 7 hours and larger complexes indicating an average of 33 hours per fund (Figure 10).

Figure 9
Estimated Time Burden of Proposed Disclosure Changes
Number of hours per fund

	SEC	ICI Respondents
Initial compliance	10	31
Ongoing compliance	-1.5	2

Figure 10
Estimated ICI Time Burden of Proposed Disclosure Changes by Complex Size
Number of hours per fund

	Smaller Complexes ¹	Larger Complexes ²
Initial compliance	7	33
Ongoing compliance	1	2

1. Smaller complexes are defined as those with \$10 billion or less in long-term mutual fund assets.

2. Larger complexes are defined as those with more than \$10 billion in long-term mutual fund assets.

In its analysis the SEC included an estimate of \$2,000 per fund in fixed costs for the proposed disclosure requirements. This cost could include stickering or reprinting of statutory and summary prospectuses and updating websites and data repositories for some funds. Overall, ICI respondents indicated that these average fixed costs would be \$6,700 per fund (Figure 11). ICI respondents at smaller complexes estimated an average per fund fixed cost of \$800, while those at larger fund complexes estimated a cost of \$7,500 (Figure 12).

Figure 11
Estimated Fixed Cost of Proposed Disclosure Changes
Dollars per fund

	SEC	ICI Respondents
Initial compliance	\$2,000	\$6,700
Ongoing compliance	\$0	\$0

Figure 12
Estimated ICI Fixed Cost of Proposed Disclosure Changes by Complex Size
Dollars per fund

	Smaller Complexes ¹	Larger Complexes ²
Initial compliance	\$800	\$7,500
Ongoing compliance	\$0	\$0

1. Smaller complexes are defined as those with \$10 billion or less in long-term mutual fund assets.

2. Larger complexes are defined as those with more than \$10 billion in long-term mutual fund assets.

We estimate that the proposed disclosure changes collectively will cost funds that have 12b-1 fees \$73 million, substantially higher than the \$23 million estimated by the SEC (Figure 13).¹⁷

Figure 13
Estimated Monetary Costs of Proposed Disclosure Changes
Millions of dollars

	SEC	ICI
Initial compliance	\$23 ¹	\$73 ²
Ongoing compliance	-\$2 ³	\$3 ⁴

1. Calculated as (10 hours from Figure 9) x (hourly rate = \$316) x (# of funds = 4,400) + (\$2,000 from Figure 11) x (# of funds = 4,400).

2. Calculated as (8 hours from Figure 10) x (hourly rate = \$375) x (# of funds with 12b-1 fees at smaller complexes = 928) + (\$800 from Figure 12) x (# of funds with 12b-1 fees at smaller complexes = 928) + (33 hours from Figure 10) x (hourly rate = \$375) x (# of funds with 12b-1 fees at larger complexes = 3,472) + (\$7,500 from Figure 12) x (# of funds with 12b-1 fees at larger complexes = 3,472).

3. Calculated as (-1.5 hours from Figure 9) x (hourly rate = \$316) x (# of funds = 4,400).

4. Calculated as (1 hour from Figure 10) x (hourly rate \$375) x (# of funds with 12b-1 fees at smaller complexes = 928) + (2 hours from Figure 10) x (hourly rate = \$375) x (# of funds with 12b-1 fees at larger complexes = 3,472).

¹⁷ We are unclear how the SEC obtained 7,367 as the number of mutual funds that have 12b-1 plans (Release at p. 47122) when calculating aggregate disclosure costs. This number is closer to the number of mutual funds overall (7,691 as of year-end 2009 in ICI Fact Book at p. 128). Lipper data for mutual funds—which includes long-term funds, money market funds, and funds of funds, but excludes variable annuities—indicates that there were 4,400 funds with 12b-1 fees as of year-end 2009. Our cost estimates are based on 4,400 funds with 12b-1 fees. If the SEC's figure is correct, however, our cost estimates would be commensurately higher.

3.3 Estimated Costs for Changes to Confirmations and Quarterly Statements

Confirm changes can be operationally difficult and costly to implement. While the SEC considered the costs to brokers and clearing firms associated with these proposed changes, it neglected to account for the costs to funds resulting from these same changes. Mutual fund transfer agents voluntarily provide confirms for accounts held directly at mutual funds. Moreover, the proposed changes would seem to affect virtually all funds that send out confirms, not just those with ongoing sales charges. For example, any fund with a marketing and service fee regardless of whether it has an ongoing sales charge would have to have the standard disclaimer. Also, as a practical matter, mutual transfer agents would likely rewrite programs to consistently apply such changes to *all* confirms and quarterly statements to ensure compliance.

We estimate funds will spend \$9 million to comply initially with the proposed changes to Rule 10b-10. The estimate for initial costs includes \$6 million in systems programming¹⁸ and \$3 million in legal costs to review the new disclosure.¹⁹

We further estimate that funds will spend \$13 million in annual ongoing costs as it is likely that a portion of the confirmation and quarterly account statements would increase in size due to the additional disclosure requirements resulting in additional paper and postage. Based on data from major mutual fund transfer agent service providers and one large mutual fund complex, we estimate that mutual fund transfer agents send out over 165 million confirms and quarterly statements for accounts held direct at funds in a year. We estimate the new disclosure requirements will add one page at a cost of \$0.16 for the additional paper and postage for half of confirms and quarterly statements mailed out annually and result in an annual ongoing charge of \$13 million to funds.²⁰

¹⁸ This figure is based on estimates from three major mutual fund transfer agent service providers and fund complexes with proprietary TAs who responded to our survey.

¹⁹ Calculated as (1 hour of legal time (internal and external) based on the results of our survey) x (hourly rate = \$375) x (the number of mutual funds = 7,691).

²⁰ Calculated as (165 million) x (0.5) x (\$0.16) = \$13 million. Although the SEC estimates an initial cost of \$258 million for intermediaries to implement Rule 10b-10 confirm changes, The SEC did not consider any ongoing costs to intermediaries related to confirm and quarterly statements mailings that may require additional paper and postage.

3.4 Total Monetary Cost to Funds from the Proposed Changes

In summary, we estimate that funds will spend \$418 million initially (Figure 14) to comply with the proposed changes to replace rule 12b-1 under the Investment Company Act of 1940, substantially higher than the SEC’s estimate of \$159 million. Almost 40 percent of the difference between the two estimates (\$98 million) is for costs associated with altering the share class structures of funds with 12b-1 fees greater than 25 basis points. ICI respondents indicated that they were more likely to amend and create share classes (a costly undertaking) than had been anticipated by the SEC. Another 40 percent of the difference (\$102 million) is for legal costs to renegotiate underwriting, dealer and other third party agreements.

Figure 14
Estimated Initial Monetary Costs of Proposed Changes
Millions of dollars

	SEC	ICI
Funds with a 12b-1 fee of 25 basis points or less ¹	\$3	\$3
Funds with a 12b-1 fee greater than 25 basis points		
Modify share class structures ²	\$133	\$231
Renegotiation of contracts ³	-	\$102
Disclosure changes ⁴	\$23	\$73
Confirmation and quarterly statement changes	-	\$9
Total	\$159	\$418

1. SEC estimates that 172 complexes only have funds that charge a 12b-1 fee of 25 basis points or less with an estimated cost of \$19,820 per complex to review and understand the proposal for a total cost of \$3 million. The Institute did not survey any of these complexes and as such will take the SEC cost estimate as given.

2. Estimates for funds with a 12b-1 fee greater than 25 basis points that would need to modify their share class structures from Figure 4.

3. Estimates for funds with 12b-1 fees greater than 25 basis points to renegotiate underwriting agreements, and dealer and other third party agreements from Figure 8.

4. Estimates for all funds with 12b-1 fees to make changes to disclosure documents from Figure 13.

We expect ongoing costs for the funds over the five-year grandfathering period to be considerable as well. The biggest cost component is for additional TA costs resulting from establishing and maintaining two accounts for current shareholders that make subsequent purchases of the newly created share class that is compliant with the proposed requirements. This \$265 million (Figure 15) is a conservative estimate as it only includes 11 complexes (with about half of the accounts that would be affected) that indicated on our survey they were likely to create new share classes. We also estimate that funds will spend \$65 million for additional paper and postage to comply with the proposed requirements to rule 10b-10. Additionally, after the five-year grandfathering period, funds will continue to incur \$ 3 million in ongoing costs to comply with the required disclosure changes and \$13 million in annual ongoing costs to comply with the proposed requirements to Rule 10b-10.

Figure 15
Estimated Ongoing Monetary Costs of Proposed Changes over Five-Year Grandfathering Period
Millions of dollars

	SEC	ICI
Funds with a 12b-1 fee greater than 25 basis points ¹	\$50	\$265
Disclosure changes ²	-\$10	\$15
Confirmation and quarterly statement changes ³	-	\$65
Total	\$40	\$345

1. The SEC estimate is the cumulative five-year cost, calculated as (\$10 million per year) x (5 years). The ICI estimate is the cumulative five-year cost for additional TA costs resulting from creating new share classes for which new accounts will be established for current shareholders that make subsequent purchases from Figure 5. This estimate should be viewed as a minimum as it only represents 11 complexes in our survey that indicated they would create new share classes.

2. Estimates for all funds with 12b-1 fees to make ongoing changes to disclosure documents from Figure 13.

3. The cumulative five-year cost of additional paper and postage for confirms and quarterly statements, calculated as (\$13 million from Figure 13) x (5 years).

4. Benefits

The SEC suggests that the costs of implementing the new rule proposal will be more than offset by benefits.

The SEC cites four general areas that it believes may lead to benefits: (1) eliminating outdated Rule 12b-1 requirements; (2) improving investor understanding of distribution charges; (3) introducing greater competition among funds in setting sales loads and distribution fees; (4) creating greater equity in the cumulative amount of sales charges paid by individual investors. These potential benefits are speculative.

The SEC estimates that the rule's adoption will create large monetary benefits. According to the SEC's analysis, investors will save between \$1.1 billion to \$1.3 billion annually. These dollar benefits arise primarily from two factors. First, investors would pay lower fees because the increased disclosure required in the rule would lead some investors to sell or exchange out of C shares into lower cost funds or share classes. Second, investors would pay lower fees as current C share investors were moved to lower cost share classes after a five year grandfathering period.

As we discuss, these monetary estimates should not be interpreted as a net benefit to investors. Instead, they are best described as a net reduction in the fees that investors may pay *through* mutual funds matched by a one-for-one dollar increase in fees that investors pay *outside* of funds or a one-for-one decline in the dollar value of services investors receive from intermediaries. Neither can be treated as a benefit to investors.

4.1 Eliminating Outdated Rule 12b-1 Requirements

The SEC believes the Rule 12b-1 regulatory structure should be modernized. Under the current structure, directors are required annually to approve a fund's 12b-1 plan. Directors have been guided in this process by a set of "factors" specified by the SEC. The Institute's position is that it would be beneficial to modernize this process in light of the developments that have occurred in the funds market since Rule 12b-1 was adopted. The SEC goes further, however, proposing guidance to directors that would require them to make determinations they are ill-suited to make. Because we and other commenters have already addressed such issues,²¹ we simply note in passing that it is not clear why it is beneficial to eliminate some board responsibilities while imposing other, inappropriate responsibilities.

²¹ See comment letters by ICI (<http://www.sec.gov/comments/s7-15-10/s71510-1065.pdf>) and Independent Directors Council, available at <http://www.sec.gov/comments/s7-15-10/s71510-1077.pdf>, and Mutual Fund Directors Forum, available at <http://www.sec.gov/comments/s7-15-10/s71510-1073.pdf>.

4.2 Improved Shareholder Understanding of Fund Fees

The rule proposal seeks to aid investor understanding of the sales and distribution fees they may pay, which in concept we support. The proposal would require funds' prospectus fee tables to categorize asset-based distribution fees as either "ongoing sales charges" or "marketing and service fees."

To the extent that investors do not understand the role or meaning of 12b-1 fees, the best way to address the issue would be to improve disclosure in prospectuses and in the disclosure that brokers and financial advisers must provide their clients.

As our cost analysis indicates though, the rule proposal is likely to cause an increase in the number of fund share classes, likely accompanied by a change of naming conventions. For example, as noted, many funds that currently have C share classes are likely to create new share classes potentially labeled as "C2." Current C share investors may ultimately end up holding both types of share classes. Whether this will be confusing to investors is an issue the SEC's benefit analysis does not address, but it may diminish the benefits of improved disclosure in the fee table.²²

4.3 Introducing Greater Competition by Loosening Section 22(d)

The SEC indicates that the proposal is intended to introduce greater competition among funds in setting sales loads and distribution fees. One way the rule proposal seeks to increase competition is by loosening the uniform pricing restrictions of section 22(d) of the Investment Company Act. As the SEC notes, section 22(d) gives funds the right to practice "retail price maintenance," a practice otherwise generally disallowed by the Sherman and Clayton Acts to other commercial enterprises. The proposal would allow funds to offer a share class sold at net asset value on which brokers could negotiate their fees directly with investors.

Regardless of whether the SEC proceeds with this aspect of the rule proposal, we believe that regulatory developments and market forces have already achieved much of what the SEC seeks. For example, as Figure 15 shows, although the stated maximum front load on A shares was 5.3 percent in 2009, the average front load fee actually paid was just 1 percent, reflecting that many funds currently sell "load-waived" A shares. This development has been fostered by competitive pressures, industry developments, and regulatory changes. For instance, the SEC's decision to allow funds to adopt load fee breakpoints and to waive front load fees on sales through retirement plans and through other distribution channels has helped front loads paid by investors to drop sharply. It is therefore unclear that this aspect of the proposal would convey significant benefits.

²² As we note on page 11, fund complexes indicated they are more likely to create new share classes because between the choices of amend only ("Route 2") or amend and create ("Route 3"), they believe amend and create could be less confusing to shareholders. Nevertheless, the new regime may still be more confusing to investors than the current scheme.

Figure 15

Front-End Sales Loads Investors Pay on Class A Shares Are Below Maximum Front-End Loads
Percentage of purchase amount

Year	Maximum front load	Front load fees paid
1990	5.0	3.9
1995	4.7	2.5
2000	5.1	1.4
2005	5.3	1.3
2009	5.3	1.0

Note: The maximum front load is a simple average of the highest front load that funds may charge as set forth in their prospectuses. Front load fees paid is calculated as the maximum front load multiplied by the ratio of total front loads collected by stock funds as a percentage of new sales of shares by such funds. Figures exclude mutual funds available as investment choices in variable annuities and funds of funds.

Sources: Investment Company Institute, Lipper, and Strategic Insight Simfund.

4.4 Promoting Greater “Equity” in Cumulative Sales Charges Paid

The rule proposal suggests that it is intended to “protect individual investors from paying disproportionate amounts of sales charges in certain share classes.”²³ Although it is not entirely clear, the SEC seems to be seeking to address two somewhat different issues.

First, the SEC expresses a concern that long-term C share investors subsidize the distribution expenses of shorter-term C share investors. By capping the amounts that investors may pay in distribution expenses through C shares, the SEC apparently hopes to prevent this. It is true that under the current regime, a short-term C share investor will pay lower distribution expenses in dollar terms over his or her horizon than another investor in the same share class who has a longer horizon. The proposed rule would not alter this: under the new regime, a short-term C share investor will still pay less in total distribution fees over his or her investment horizon than would another investor in the same share class with a longer horizon. But it is unclear why this creates a subsidy or inequity. For example, under the current regime, each C share investor pays an *identical* price of 100 basis points *per unit of time* invested in the fund for ongoing services rendered.

Second, the SEC may be concerned that some longer-term C share investors could be paying more in distribution fees than they if they had originally selected A shares. For example, the SEC states that “long-term C class shareholders ... may pay significantly more in asset-based distribution fees than

²³ Release, p. 47109.

if they had instead invested in some other class,”²⁴ presumably A shares. Whether C share investors cumulatively pay more over time in distribution fees than they would in A shares depends on their holding periods. As Figure 16 shows, a shareholder who initially invests \$10,000 in a taxable account with a first breakpoint at \$50,000 and whose holding period is 8 years or less will generally pay lower total distribution fees in C shares than in A shares if A shares incur a front-load of 6.25% (the default benchmark front-load fee in the SEC’s rule proposal). Only if the investor has a holding period of more than 8 years and four months, will he or she incur lower distribution fees in A shares.

Figure 16
Distribution Cost of Class A Shares versus Class C Shares¹
Dollars incurred for an initial investment of \$10,000

Holding period (years)	A shares ²	C shares ³
1	\$776	\$189
2	\$947	\$405
3	\$1,138	\$650
4	\$1,353	\$928
5	\$1,593	\$1,241
6	\$1,862	\$1,595
7	\$2,163	\$1,992
8	\$2,497	\$2,438
9	\$2,870	\$2,937
10	\$3,285	\$3,494

¹ Assumes a market rate of return of 8% per year.

² Assumes A shares incur a front-load of 6.25% of initial \$10,000 purchase, an ongoing 12b-1 fee of .25% per year and other expenses of .75% per year.

³ Assumes an ongoing 12b-1 fee of 1.00% of assets per year and other expenses of .75% per year.

Source: Investment Company Institute

It is unknown whether individual C share investors typically have holding periods that long. As the SEC notes, “[c]omprehensive data on the typical retention period for C shares is not available.”²⁵

²⁴ Release, p. 47119.

²⁵ Release, p. 47120.

Nevertheless, as Figure 16 indicates, economic incentives encourage investors with shorter holding periods (or those with uncertain investment horizons) to select C shares. Indeed, in arguing that intermediaries will suffer little reduction in compensation as the result of the rule proposal, the SEC itself assumes that C share investors must have relatively short holding periods:

we expect that only a limited portion of outstanding Class C share classes would be held long enough for any asset-based distribution fees on Class C shares to exceed the proposed ongoing sales charge limit... a C share investor could pay an ongoing sales charge of 75 basis points for approximately 8 years before reaching the ongoing sales charge limits we propose today. *This holding period [i.e., 8 years] would be more than double the typical holding period for all fund shares, and particularly long for C shares, which funds disclose as appropriate for short-term investors* [emphasis added].²⁶

Finally, the SEC's goal of creating equity through the imposition of fee caps ignores market realities. As discussed below, the price investors must pay for intermediary services is ultimately determined by the market. Fee caps cannot get around that. In fact, fee caps most likely will simply drive payments for intermediary services outside of funds (such as into wrap account fees).

4.5 Monetary Benefits

The SEC estimates that the rule's adoption will create large monetary benefits. According to the SEC's analysis, investors will save between \$1.1 billion to \$1.3 billion annually. These savings arise primarily from:

- *Investors will save \$170 million to \$340 million annually in asset-based distribution fees because the increased disclosure required in the rule will lead some investors to sell or exchange out of C shares into lower cost funds or share classes.*
- *Investors will pay \$858 million less annually in asset-based distribution fees because current C share investors will be migrated to lower cost share classes after a five-year grandfathering period.*

These estimates, as we discuss, appear to be based primarily on the assumption that the SEC can cap asset-based distribution fees, that investors will pay less in total to invest in funds, and that all else will remain unchanged. This is highly implausible. In general, price restrictions, which are what fee caps are, create dislocations because demand outstrips supply at the restricted price. To avoid such dislocations, suppliers (*e.g.*, fund intermediaries and sponsors) may seek alternative pricing mechanisms

²⁶ Release, p. 47120.

or market products that are not price-restricted. When they cannot do so, product quality, availability, and product-related service deteriorate.

In the case at hand, the SEC's estimated \$1.1 billion to \$1.3 billion annual benefits are predicated on the view that fund intermediaries will provide identical services for vastly lower compensation. This ignores market realities. The price of intermediary services is determined by the market. Intermediaries require a given level of compensation for the nature, quality, and quantity of services they provide to investors. Capping fees that investors pay through funds will not change this: if intermediaries cannot receive the market-determined level of compensation through fund-related payments (*i.e.*, through 12b-1 fees or load fees), they will seek that compensation outside of funds, such as through account-level charges (*e.g.*, account level charges) or the promotion of products where fees are not capped (*e.g.*, separate accounts). Intermediaries may also seek greater revenue sharing from fund advisers.

The SEC has asked for comment on whether its estimated reductions in sales charges investors would pay are a net benefit of the proposal. The answer is no. Capping the asset-based distribution fees that investors may pay through funds will lead to a change in the form of compensation paid to intermediaries, but not an overall reduction in that compensation. In short, the SEC's estimates are best described not as a net benefit to investors, but as a reduction in the asset-based fees that investors would pay *through* mutual funds matched by a one-for-one dollar increase in fees elsewhere.

4.5.1 Assumption: Better Informed Investors Save \$170 Million to \$340 Million Annually by Switching from Class C Shares to Lower-Cost Funds or Share Classes

The rule proposal would require funds to label ongoing asset-based service fees as “marketing and service fees” in fund prospectuses and other fund literature. Asset-based sales charges would be labeled as “ongoing sales charge.” According to the SEC, by more clearly identifying the two different types of asset-based distribution fees, investors would make better choices. In particular, investors could “more easily compare sales charges in alternative share classes and competing funds and, therefore, choose the sale charge option that best meets their investment needs.”²⁷

The SEC takes the position, with which we would agree, that better disclosure on fund fees is beneficial for investors. However, the SEC goes further, estimating that the change in disclosure will lead some C share investors to shift to lower cost share classes, annually saving \$170 million to \$340 million.

It is not at all clear what assumptions the SEC relies on to achieve these estimates. One interpretation might be that the SEC expects better disclosure to result in greater competition for

²⁷ Release p. 47118.

investor dollars, thus driving down the fees that investors pay for intermediary services. If so, such an outcome is best achieved by modifying the regime for disclosing distribution fees, but it does not indicate a need to restrict distribution fees paid through funds.

Another possible interpretation is that the SEC believes that some C share investors are paying needlessly for the assistance of financial intermediaries and, if better informed, would switch to no-load funds, thus saving on distribution fees. If this is what the SEC has in mind, it provides no supporting evidence.

However, the analysis suggests a third alternative. The SEC states that:

We anticipate that [better information on fund distribution fees] would lead investors to choose lower priced offerings of funds or share classes that offer *comparable* services [emphasis added] ... [I]mproved investor understanding of distribution related charges would result in an aggregate total of between five and ten percent of assets currently invested in level load classes (for example, C shares) moving to share classes ... that do not deduct an asset-based distribution fee [and] ... investors would save approximately \$170 million ... [to] \$340 million annually.²⁸

This seems to suggest that the SEC believes C share investors can migrate to no-load funds, pay no distribution fees, but continue to receive the same level of intermediary services. If this is what the SEC has in mind, it is unrealistic. C share investors can shift to no-load funds, but those who want *comparable* service will have to pay for it at the market-going rate, such as through account level fees or wrap fees paid outside the fund. Current C share investors may thus save on fees paid *through* funds, but there is no *net* benefit because they will still have to pay for the service and assistance they receive from intermediaries.²⁹

²⁸ Release, p. 47118. The SEC calculates the estimated monetary benefits as follows. The SEC estimates that the total assets held in level load share classes are \$686 billion. Next, the SEC assumes that the average 12b-1 fee paid on these assets is 50 basis points. Given these estimates, if investors move five percent of those assets to share classes without asset-based distribution fees, they would save \$170 million annually ($\$686 \text{ billion} \times (50/10,000) \times 5\%$). If investors moved ten percent of those assets, they would save \$340 million annually ($\$686 \text{ billion} \times (50/10,000) \times 10\%$).

²⁹ Indeed, the SEC's analysis acknowledges this point: "some investors might ... need or want continuing high levels of service, and may choose to move their assets out of level load share classes and into fee-based or wrap fee accounts, which may have higher expenses than the level load share classes the investor had previously owed. Release at p. 47119.

4.5.2 Assumption: Investors Pay \$858 Million Less Annually in Asset-Based Distribution Fees Because Current Class C Share Investors Are Transferred to Lower Cost Share Classes After a Five-Year Grandfathering Period

The SEC's analysis argues that investors will benefit very substantially—\$858 million annually—due to the fact that after a five-year grandfathering period remaining C share investors must be converted to a share class with an ongoing asset-based fee of at most 25 basis points.³⁰

This estimated \$858 million annual benefit appears predicated on the view that fund intermediaries will accept a reduction in the fees they receive for their services. This does not reflect market realities. Brokers and financial advisers expect to receive the market-determined rate for the services they provide. Industry reports and discussions with ICI member firms indicate that this price is the range of 100 to 150 basis points (or more depending on the services provided) of assets under management. If intermediaries cannot receive this market-determined rate of compensation *through* funds, they will seek it outside of funds, such as through account level fees or wrap account fees. Capping the asset-based distribution fees that investors can pay through funds cannot change this.

At a different level, the SEC provides no meaningful cost-benefit analysis of a number of significant issues. For example, the new distribution scheme risks skewing intermediary incentives toward promoting products where distribution fees are not capped but that are not subject to the protections of the Investment Company Act. Would this be costly or beneficial for fund investors?

Another significant concern is that the SEC's estimated \$858 million annual benefit lacks any recognition that retirement share classes pay for unique services. Forcing investors out of level load share classes will not eliminate the need to pay for the services that investors in retirement share classes receive from intermediaries. The Institute's comment letter notes that the use of 12b-1 fees in the retirement plan context is far different from the nonretirement plan context. In the retirement plan context, the broker provides a variety of ongoing services that are unique to retirement plans, important to plan participants, and rendered over the entire life cycle of the plan. A more meaningful cost-benefit analysis would take seriously the question of whether the rule proposal may stifle the future development of R shares and more broadly preclude mutual funds from being used within certain retirement plans and whether that would be beneficial or costly for retirement plan participants.

³⁰ Mechanically, the SEC arrives at its \$858 million annual benefit as follows. The SEC estimates that the total assets held in level load share classes are \$686 billion. Next, the SEC assumes that the average 12b-1 fee paid on these assets is 50 basis points. Given these estimates, if 50 percent of those assets remain in existing level load share classes after five years, they must move to share classes with ongoing asset-based fees of no more than 25 basis points. These investors will thus save 25 basis points per year in asset-based fees paid through funds. The SEC takes this to imply that investors will in aggregate pay \$858 million less annually in asset-based fees ($\$686 \text{ billion} \times 50\% \text{ moving to lower asset-based fee accounts} \times (25 \text{ basis points}/10,000)$).

Appendix

Investment Company Institute

Survey Questions on SEC Rule 12b-1 Reform Proposal

Questions for Fund Complexes Regarding 12b-1 Reform Proposal

September 17, 2010

Please respond to as many questions as you can. Even if you are unable to provide complete answers to some questions, the information you can provide is still valuable.

1. Please input in the attached spreadsheet quantitative responses regarding estimated hours and dollar costs—respond separately for initial costs and on-going costs.
2. For the hours and dollar cost estimates, please aggregate across all affected funds in your complex. We understand that these estimates may be difficult to assess at this stage; please provide your best educated guess. Also, please provide as much detail as possible using the cost categories provided; however, if you cannot provide the detail, aggregate the cost categories as is appropriate for your complex.
3. When estimating costs, please include costs that would be borne directly by your affiliated service providers and the fund complex, or indirectly through increased expenses charged by your unaffiliated service providers.
4. If there are additional line items for costs that are applicable for your complex, please use the “other” category provided and insert as many rows as necessary in the spreadsheet, and provide a brief description of the cost item.
5. For those respondents that offer either retirement shares (*e.g.*, “R” shares) or money market fund shares used in sweep products, we understand that these shares are likely to face unique issues from the SEC proposal. To the extent possible, please provide any additional cost information that may be applicable for retirement or sweep vehicle shares that are not captured in other areas already addressed by the survey. Please clearly identify those costs from any other additional costs you may add into the spreadsheet as directed in instruction #1.
6. It may be helpful in completing the survey to reference Section 5 “Cost Benefit Analysis” in the SEC’s release at <http://www.sec.gov/rules/proposed/2010/33-9128.pdf>
7. Please input written responses directly into this document. Written responses could also include a description of any factors that may result in higher or lower cost estimates.

8. Please email both the spreadsheet with cost estimates and your written responses to Shelly Antoniewicz at shelly@ici.org by **October 15, 2010**.
9. If you have any questions regarding the questionnaire, please call Shelly Antoniewicz at 202-326-5910 or Kathy Joaquin at 202-326-5930.

Each complex's individual responses will remain confidential. Data will be aggregated across complexes to obtain summary statistics that may be used in our comment letter to the SEC.

Some of the questions in this survey may seem familiar to those of you who received a 12b-1 Reform questionnaire from the SEC approximately three years ago. For these complexes, it may save time in responding to this questionnaire to review and update those responses for any changes in your complex's cost structure and distribution arrangements.

I. Ongoing Sales Charges: Funds

A. Options: Fee Reduction, Fee Restructuring, or Conversion/Modified Share Classes

The SEC has contemplated several options that funds may utilize if the amendments to rule 6c-10 are adopted as proposed. These include a reduction in asset-based distribution fees to 25 basis points, restructuring 12b-1 fees in excess of 25 basis points as fund operating expenses, and amending, modifying, or creating conversion systems and share classes with ongoing sales charges.

1. Please answer all that apply. For those share classes in your complex with a 12b-1 fee greater than 25 basis points, would your firm:
 - a. Simply reduce the fund's asset-based distribution fees to the 25 basis point cap for marketing and service fees and not create a new share class with an on-going sales charge? For example, if the current 12b-1 fee is 30 basis points, would the complex lower it to the 25 basis point cap and not try to recoup the additional 5 basis points through an on-going sales charge? For additional reference, please see page 178 in the SEC release at <http://www.sec.gov/rules/proposed/2010/33-9128.pdf>
 - b. Restructure the amount of the 12b-1 fee in excess of 25 basis points to be reclassified as a fund operating expense? For additional reference, please see page 179 in the SEC release at <http://www.sec.gov/rules/proposed/2010/33-9128.pdf>
 - c. Amend, modify, or create conversion systems and new share classes with an ongoing sales charge? If so, which of the SEC's "route(s)" would your firm expect to undertake and why? Since firms may decide to implement more than one route depending on their existing class structure, please discuss each route your firm might take. For additional reference, please see pages 181-192 in the SEC release at <http://www.sec.gov/rules/proposed/2010/33-9128.pdf>
 - i. Route 1: Retain existing share class structure and conversion system.
 - ii. Route 2: Update existing conversion system and amend share class structure.

- iii. Route 3: Update existing conversion system, amend class structure, and create new share classes.
- iv. Route 4: Create/purchase new conversion system, amend class structure, and create new share classes.

2. If your firm chooses to amend, modify, or create new share classes, please mark the likelihood of Routes 1-4 being undertaken by your firm.

(a) Definitely (b) Most Likely (c) Somewhat Likely (d) Unlikely (e) Not at all

Route 1: _____ Route 3: _____
 Route 2: _____ Route 4: _____

B. Renegotiation of Contracts

3. Based on whether your firm expects to reduce or restructure fees or modify or create share classes by using the routes that your firm is definitely, most likely, or somewhat likely to employ (see question 2 above), please estimate what would be the costs in hours and dollars of amending the funds’ agreements (including underwriting, dealer, and other third-party agreements). Such costs may include (but are not limited to) outside legal fees and internal legal, board of directors, and administrative costs. Please input these cost estimates in the attached spreadsheet. Your response should **exclude** costs associated with the creation of a new optional NAV share class, as we will cover this issue separately.

C. Reduce Fees, Restructure Fees and Conversion/Modified Share Classes

4. What would be the costs in hours and dollars of reducing or restructuring fees, and/or converting, amending, or creating share classes using the routes that your firm is definitely, most likely, or somewhat likely to employ (see question 2 above) to comply with the proposed requirements? Please input both initial and ongoing costs in the attached spreadsheet. Your response should **exclude** costs associated with the creation of a new optional NAV share class. Whether provided internally or through unaffiliated vendors, please include, in your estimate, costs for:

- Time spent by staff in legal (including outside legal fees), fund operations, fund administration (including accounting), and distribution,

- Time spent educating and training staff and communicating and coordinating modifications with intermediaries in the affected funds' distribution channels,
- New systems requirements and programming for updating or implementing conversion/aging systems, share lot transfer systems, and to comply with the proposal's amendments to rule 11a-3 (which would require funds to give shareholders "credit" against the rate of any sales load owed for ongoing sales charges paid by investors who exchange fund shares with a fund group),
- New marketing materials used for investors and intermediaries, blue sky fees, printing, fees for NASDAQ symbols, and CUSIPs.

D. Revisions to Disclosure Documents

5. As part of the proposal, changes to funds' disclosure documents (fee table on Form N-1A, prospectus, SAI, N-SAR, Regulation S-X, Forms N-3, N-4, and N-6 and streamlined proxy procedure) will be required.
 - a. Please estimate the amount of time and dollar cost to make these changes initially and input these costs in the attached spreadsheet. Please include in your estimate costs such as outside legal fees, internal staff time or other costs. Your response should **exclude** costs associated with the creation of a new optional NAV share class.
 - b. Do you expect the new disclosure requirements to result in more, the same, or less time than currently spent on updating these disclosures on an annual on-going basis? If more or less, please estimate the time cost or saving and input into the ongoing cost section of the attached spreadsheet (enter savings as a negative). Your response should **exclude** costs associated with the creation of a new optional NAV share class.

II. Rule 10b-10 Confirmations and Quarterly Statements

Funds currently comply with SEC Rule 10b-10 for accounts held direct at the fund (*i.e.*, accounts not being confirmed by an intermediary). The proposed amendments to Rule 10b-10 transaction confirmations and quarterly statements would require new information.

- At the time of purchase of a mutual fund security, confirms and quarterly statements will be required to include amount of any sales charge in percentage and dollar terms; applicable breakpoint or similar threshold used; maximum amount of any deferred sales charge that the customer may incur in the future; annual amount of the ongoing sales charge as a percentage of net asset value; and the maximum number of months or years that the customer will incur ongoing sales charge; and statement on additional fees and expenses in connection with owning the mutual fund.
 - In the case of a redemption or sale of a mutual fund security, confirms and quarterly statements would be required to include the amount of any deferred sales charge that the customer paid expressed in dollars and as a percentage of the net asset value.
6. For the most recent time period available, please indicate the total net assets and number of accounts for which your complex provides 10b-10 confirms and quarterly statements.

Total net assets : _____

Number of accounts: _____

7. Please estimate the amount of time and dollar cost to make these proposed changes (initially and on an on-going annual basis) to confirms and quarterly statements and input these costs in the attached spreadsheet. Please include in your estimate costs such as outside legal fees, internal staff time, new systems requirements and programming, and administrative costs including paper, postage, etc.

III. Creation of an NAV Share Class

8. One feature of the 12b-1 reform proposal is the option for a fund to create an NAV share class on which brokers can negotiate commissions. At this time, is this something your firm would contemplate for any of its funds? Please highlight the factors (costs and/or benefits) that might influence your decision.

IV. Director Responsibilities

9. How much time do you expect your firm's fund boards to spend on overseeing the initial implementation of 12b-1 reform? Please include these estimates in the attached spreadsheet in the line item director responsibilities under the categories "Renegotiation of Contracts" and "Reduce Fees, Restructure Fees and Convert/Modify Share Classes."
10. On an on-going annual basis, do you expect a reduction in time spent by your firm's fund boards on oversight of distribution activities?

	Initial Costs		Ongoing Annual Costs	
	Hours	Dollars	Hours	Dollars
I. Ongoing Sales Charges: Funds				
B. Renegotiation of contracts				
<i>Underwriting agreements</i>				
Outside legal fees				
Internal legal/admin costs				
Directors				
Other (provide brief description)				
<i>Subtotal</i>				
<i>Dealer and other third-party agreements</i>				
Outside legal fees				
Internal legal/admin costs				
Directors				
Other (provide brief description)				
<i>Subtotal</i>				
C. Modify Share Class Structure				
Internal legal				
Outside legal fees				
Directors				
Fund administration				
Fund operations				
Transfer agent				
Systems/programming				
Distribution				
(including intermediary communication/education, etc.)				
Educating/training staff				
Marketing materials				
Printing				
NASDAQ symbol				
CUSIP bureau				
Other (provide brief description)				
<i>Subtotal</i>				
D. Revisions to disclosure documents				
<i>Fee table, prospectus, and SAI</i>				
Outside legal fees				
Internal legal				
Other (provide brief description)				
<i>Subtotal</i>				
II. 10b-10 confirms and quarterly statements				
Outside legal fees				
Internal legal				
Systems/programming				
Administrative costs (paper, printing, postage, etc.)				
Other (provide brief description)				
<i>Subtotal</i>				
Total				