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FOUNDATION FOR FIDUCIARY STUDIES

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FOR IMMEDIATE RELEASE

Guide to SEC Proposed Repeal of 12b-1 Fees

The potential negative impact on the formation of retirement plans

Pittsburgh, PA, February 18, 2004—The **Foundation for Fiduciary Studies** has prepared the following response to assist members of the press and other interested parties in understanding the issues associated with the SEC proposal to repeal Rule 12b-1.

One of the issues addressed at the SEC's open meeting on Feb. 11, 2004 was a proposed amendment to Rule 12b-1 under the Investment Company Act of 1940. The proposal includes the repeal of 12b-1 fees, and the SEC is requesting comment on the need for additional changes. The URL for the SEC's proposal:

<http://www.sec.gov/news/press/2004-16.htm>

The 12b-1 fee is an annual percentage charge (typically 25 basis points [0.25%], but can be as high as 100 basis points) that is embedded in a fund's annual expense ratio. The SEC first permitted the use of 12b-1 fees in 1980 for the purpose of providing mutual funds (particularly no-load funds) with the opportunity to pay for marketing and distribution expenses out of the fund's assets. Originally, it was thought that the 12b-1 fee would help investors because, as the assets in the fund grew, the fund's expense ratio would decrease because the fund's total expenses would be spread across a larger pool of dollars.

To date, there is no widely regarded evidence to suggest that the use of 12b-1 fees have enabled mutual funds to reduce their expense ratios. On the contrary, critics state that expense ratios have actually increased. Furthermore, over time the investment industry has become "creative" in the use of 12b-1 fees, and not always in the best interests of the investing public. For example, 12b-1 fees are used as a substitute for a mutual fund's sales load, obscuring the investor's investigation as to whether a particular mutual fund is a "load" or "no-load" fund.

For these reasons, the **Foundation for Fiduciary Studies** supports the SEC’s proposal, with one major exception:

Continue to permit the use of 12b-1 fees, but restrict their use to mutual funds being used as retirement plan investment options—in essence require the creation of a retirement plan share class (for example, create an R-Class). In addition, require retirement plan vendors to report to the plan sponsor each year the actual dollar amounts of the 12b-1 fees generated from the retirement plan assets, and how the 12b-1 fees were utilized for the exclusive benefit of the retirement plan. For example, the retirement plan vendor would be required to disclose to the plan sponsor the specific dollar amounts that were allocated towards:

- Plan recordkeeping and administration
- Participant education
- Investment counsel
- Trustee services
- Custodial services.

Donald B Trone, the **Foundation’s** president, has expressed concern that the elimination of 12b-1 fees would discourage the formation of 401k plans, since 12b-1 fees often are an important means of amortizing the initial start-up costs associated with “bundled” 401k services. (“Bundled” means that the above services are all, or mostly, quoted as one fee; with the 12b-1 fees used as the primary fee offset.) Without 12b-1 fees, start-up costs associated with 401k plans will increase, and fewer retirement plans will be started, which is not in the public’s best interests.

By requiring full disclosure of the “bundled” entities that are compensated by 12b-fees, the plan sponsor would be better armed with the information needed to fulfill its critical fiduciary duty to properly control and account for all investment-related expenses. In fact, as the plan assets grow, the plan may actually reach a “cross-over” point, where it makes economic sense to “unbundle” the plan’s services and put each of the services out for separate bid, including the utilization of mutual funds with lower expense ratios that do not include 12b-1 fees.

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*The **Foundation for Fiduciary Studies** was established in 2000 for the purpose of defining the practices that detail a prudent process for investment fiduciaries. The Foundation is part of the trilogy of organizations focused solely on the subject of investment fiduciary responsibility that make up the unincorporated entity, **Fiduciary 360** (www.fi360.com). The other associated organizations include the **Center for Fiduciary Studies**, which is associated with the **University of Pittsburgh Joseph M. Katz Graduate School of Business**; and **Fiduciary Analytics**, which develops Web-based tools based on the fiduciary practices for investment decision-makers.*

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