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Fink to Debunk '12b-1 Myths' at SEC Roundtable

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Former ICI president **Matt Fink** will set the record straight on what he calls a number of 12b-1 fee misconceptions at an upcoming SEC roundtable on the topic June 19.

The meeting comes in the face of intense regulatory scrutiny over the fees.

Among the topics Fink will attempt to "clear up" is the idea that 12b-1 fees should not be used to compensate brokers and that the fees are temporary. Fink bases his knowledge of the so-called misconceptions on research he has gathered for a book he is writing on the history of the fund industry.

It is widely believed that the SEC originally created the rule and allowed fund firms to charge the fee so they could push some marketing expenses onto shareholders. The logic was that marketing would help funds grow their assets. Therefore, shareholders would benefit, because as the asset base increases, the expenses of the fund decline. That's because the fund benefits from the economies of scale that come along with more assets.

The SEC has limited the 12b-1 fee to 1% annually with a maximum of .25% going to brokers. The ICI has shown that a large majority of the fee is going to pay brokers.

However, 12b-1 fees have been under the spotlight in recent years as many have claimed they're not being used as regulators intended. Observers have paid particular attention to the fact that fund firms have been charging the fees to pay for broker services, including initial and ongoing investment advice.

Many practices in the fund industry came under scrutiny after the market-timing scandal a few years back, and the SEC has made it clear that 12b-1 fee practices would be examined, poked and prodded.

Fink, in his testimony, will refute the idea that 12b-1 fees were meant to pay for advertising costs and not to compensate dealers. He provided *Ignites* with an advance copy of his remarks.

"Rule 12b-1 expressly speaks of 'compensation of underwriters, dealers and sales personnel.' Why has a misconception developed that the commission did not contemplate use of 12b-1 fees to compensate dealers? ...While in 1980 observers knew that the ... fees might be used to pay dealers, they did not foresee the development of spread-load plans where payments are so large as to fully substitute for traditional 5%-6% front-end sales loads." Spread-load plans are fee-payment structures paid out over an extended period of time rather than right up front.

Also, talking about the misconception, as he calls it, that 12b-1 fees are supposed to be temporary, Fink says, "There is no evidence that the commission believes that a fund must cease 12b-1 payments when net redemptions end."

Fink, who was not available for comment as of deadline, also states that a misconception exists that the SEC has not revisited 12b-1 fees for 27 years.

In 1988, the commission proposed amending the rules to eliminate spread-load plans, he says. Also, in 1992 the Division of Investment Management recommended that, in light of the National Association of Security Dealers' proposal to amend its sales charge rule to include 12b-1 fees, only limited changes be made to the rule.

In 2004, he says, the commission amended the rule to prohibit funds from paying for distribution of their shares with brokerage commissions.

"The use of 12b-1 fees, and the distribution model of the fund business, has evolved significantly since [the adoption of 12b-1 fees] in 1980," says **Ed Giltenan**, spokesman for the ICI. "Our research shows that the vast majority of the fees — more than 90% — are used to pay for advice and other essential services for existing shareholders. Only 2% is used for advertising promotion."

Paul Haaga, executive vice president of Capital Research (parent to American Funds) and vice chairman of the ICI's board of governors, will also speak at the event. He was not available for comment as of deadline. The SEC released a full [list](#) of panelists on June 12.

Shareholders who do not use advisors to make their trades are not receiving any benefit from 12b-1 fees that are going to brokers for their advising services, according to **Niels Holch**, executive director of the Coalition of Mutual Fund Investors.

"The mutual fund is taking this out of everybody's account, but it's only benefiting those buying through an intermediary," Holch says.

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