

SUPPORTING STATEMENT
RULE 12b-1

A. JUSTIFICATION

1. Necessity for the Collection of Information

Section 12(b) of the Investment Company Act of 1940 (“the Act”) (15 U.S.C. 80a-12(b)) prohibits a registered open-end investment company (“fund” or “mutual fund”) from acting as a distributor of securities that it has issued, except through an underwriter, in contravention of Commission rules. Rule 12b-1 under the Act (17 CFR 270.12b-1) permits a mutual fund to bear expenses associated with the distribution of its shares, provided that the fund complies with certain recordkeeping and other requirements. The rule requires, among other things, that the fund adopt a written plan describing all material aspects of the proposed financing of distribution (“rule 12b-1 plan”). The plan must be approved by the fund’s board of directors, including the independent directors, and by a majority of the fund’s outstanding voting securities. Any material amendments to the rule 12b-1 plan similarly must be approved by the fund’s directors, and any material increase in the amount to be spent under the plan must be approved by the fund’s shareholders. In considering a rule 12b-1 plan, the fund’s board must

request and evaluate information reasonably necessary to make an informed decision. In implementing or continuing a plan, the board must conclude in the exercise of reasonable business judgment and in light of the directors' fiduciary duties that there is a reasonable likelihood that the plan will benefit the fund and its shareholders.

Rule 12b-1 requires that all agreements with any person relating to the implementation of the plan be in writing and that they be approved by the board of directors, including the independent directors. The plan and the agreements must incorporate certain specified provisions, including that: (i) the fund's board conduct quarterly reviews of written reports of the amounts spent under the plan; (ii) the board specifically approve the continuance of the plan at least annually; and (iii) the plan may be terminated at any time by the vote of a majority of the independent directors on the board. Rule 12b-1 also requires the fund to preserve for six years copies of the plan, any related agreements and reports, as well as minutes of board meetings that describe the factors considered and the basis for implementing or continuing a rule 12b-1 plan.

Rule 12b-1 also prohibits funds from paying for distribution of fund shares with brokerage commissions on their portfolio transactions, and requires a fund that uses a broker-dealer that sells its shares to execute the fund's portfolio securities transactions to implement policies and procedures reasonably designed to prevent: (i) the persons responsible for selecting broker-dealers to effect transactions in fund portfolio securities from taking broker-dealers' promotional or sales efforts into account in making those decisions; and (ii) the fund, its adviser or principal underwriter, from entering into any agreement under which the fund directs brokerage transactions or revenue generated by those transactions to a broker-dealer to pay for distribution of the fund's shares.

2. Purposes of the Information Collection

Rule 12b-1 enables funds to use their own assets to pay for distribution of fund shares. The board and shareholder approval requirements of the rule are designed to ensure that fund shareholders and directors receive adequate information to evaluate and approve a rule 12b-1 plan and, thus, are necessary for investor protection. The requirement of quarterly reporting to the board is designed to ensure that the rule 12b-1 plan

continues to benefit the fund and its shareholders. The recordkeeping requirements of the rule are necessary to enable Commission staff to oversee compliance with the rule.

The requirement that funds or their advisers implement, and fund boards approve, policies and procedures in order to prevent persons charged with allocating fund brokerage from taking distribution efforts into account is designed to ensure that funds' selection of brokers to effect portfolio securities transactions is not influenced by considerations about the sale of fund shares.

3. Role of Improved Information Technology

The Commission's Electronic Data Gathering, Analysis and Retrieval System ("EDGAR") provides for the automated filing, processing and dissemination of full disclosure filings. The automation provides for speed, accuracy and public availability of information, generating benefits to investors and financial markets. Although rule 12b-1 does not require the filing of any documents with the Commission, the Commission may use its EDGAR facility in the future to improve the examination of records funds must keep under the rule. The Electronic Signatures in Global and National

Commerce Act and the conforming amendments to rules under the Investment Company Act permit funds to maintain records electronically.

4. Efforts to Identify Duplication

The Commission periodically evaluates rule-based reporting and recordkeeping requirements for duplication, and reevaluates them whenever it proposes a rule or form, or a change in either. Rule 12b-1 does not require duplicative reporting or recordkeeping. Although rules 31a-1 and 31a-2 under the Investment Company Act (17 CFR 270.31a-1 and 270.31a-2) generally require the preservation of records including board minutes, rule 12b-1 specifies substantive issues to be addressed in the board minutes. Although the requirement for policies and procedures is encompassed by the more general requirement for compliance policies and procedures contained in rule 38a-1 under the Investment Company Act,¹ the requirement is intended to ensure the active monitoring of brokerage allocation decisions when executing brokers also distribute the fund's shares.

5. Effect on Small Entities

The recordkeeping requirements of rule 12b-1 are the same for all funds that choose to rely on the rule, including small entities. Rule 12b-1 is not mandatory, and funds may choose other distribution arrangements. All

¹ 17 CFR 270.38a-1.

funds that use their selling brokers to execute fund portfolio securities transactions are required to adopt policies and procedures. The Commission does not believe that compliance with rule 12b-1 is unduly burdensome for small entities.

6. Consequences of Less Frequent Collection

Rule 12b-1 requires information to be provided to fund directors:

(i) when a rule 12b-1 plan and any related agreements are implemented, or when a material amendment is made to the plan, (ii) quarterly in connection with reports concerning amounts spent under the plan, and (iii) annually when the board decides whether to continue the plan. The fund also must provide information to fund shareholders in connection with their vote on the plan and any material increases in amounts spent under the plan. These requirements are necessary to ensure proper approvals by fund boards and shareholders in connection with the adoption or amendment of rule 12b-1 plans, and to ensure that fund boards can monitor payments made under the rule 12b-1 plan. These requirements also are necessary for Commission staff to monitor the duties and responsibilities of fund boards and to determine

fund compliance with the requirements of the rule. Rule 12b-1 also requires that funds implement (and their boards approve) policies and procedures to prevent distribution efforts from being a factor in the selection of executing brokers before using a broker that sells fund shares to execute portfolio transactions. This requirement is necessary to ensure the active monitoring of brokerage allocation decisions when executing brokers also distribute the fund's shares.

7. Inconsistencies with Guidelines in 5 CFR 1320.5(d)(2)

Rule 12b-1 requires funds to retain certain written records for more than three years. Funds relying on rule 12b-1 must preserve copies of the rule 12b-1 plan, related agreements, board minutes and other reports required under the rule for at least six years, and to maintain such records in an easily accessible place for the first two years. The long-term retention of these records is necessary for the Commission's staff to determine compliance with rule 12b-1.

8. Consultations Outside the Agency

The Commission has sought and received public comments on rule 12b-1 and each rule amendment before its adoption.² In addition, before

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See Investment Company Act Release No. 10862 (Sept. 7, 1979) (44

submitting this request for an extension and approval of the information collections under rule 12b-1, the Commission requested public comment on those information collections. The Commission received no responses to this request. In addition, the Commission and the staff of the Division of Investment Management continue to participate in an ongoing dialogue with representatives of the mutual fund industry through public conferences, meetings and informal exchanges. These various forums assist the Commission and its staff to ascertain the magnitude of and act upon paperwork burdens confronting the industry.

9. Payment or Gift to Respondents

Not applicable.

10. Assurance of Confidentiality

Not applicable.

FR 54014 (Sept. 17, 1979)); Investment Company Act Release No. 16431 (June 13, 1988) (53 FR 23258 (June 21, 1988)); Investment Company Act Release No. 19955 (Dec. 15, 1993) (58 FR 68074 (Dec. 23, 1993)); Investment Company Act Release Nos. 21660 (Jan. 5, 1996) (61 FR 1313 (Jan. 19, 1996)) and 22203 (Sept. 9, 1996) (61 FR 49022 (Sept. 17, 1996)); Investment Company Act Release No. 26356 (Feb. 24, 2004) (69 FR 9726 (Mar. 1, 2004)).

11. Sensitive Questions

Not applicable.

12. Estimates of Hour Burden

The number of hours required to comply with rule 12b-1 will vary considerably depending on several factors, including the complexity of the rule 12b-1 plan and the number of classes of fund shares covered by the plan. Based on information filed with the Commission by funds, Commission staff estimates that there are approximately 6,536 mutual fund portfolios with rule 12b-1 plans.³

Rule 12b-1 requires the board of each fund with a rule 12b-1 plan to (i) review quarterly reports of amounts spent under the plan, (ii) annually consider the plan's continuation (which generally is combined with the fourth quarterly review), (iii) have each fund document the policies and procedures it has implemented to enable it to effect portfolio securities transactions through an executing broker that also distributes the fund's shares, and (iv) approve those policies and procedures.

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This estimate is based on information from the Commission's NSAR database as of June 1, 2006.

The number of annual responses per fund portfolio will be four per year. Thus, we estimate that funds will make 26,144 responses (6,536 fund portfolios x 4 responses per fund portfolio = 26,144 responses) each year.

Based on conversations with fund industry representatives, Commission staff estimates that for each of the 6,536 mutual fund portfolios that currently has a rule 12b-1 plan, the average annual burden of complying with the rule is 100 hours to maintain the plan. This estimate takes into account the time needed to prepare quarterly reports to the board of directors, the board's consideration of those reports, and the board's annual consideration of the plan's continuation. We therefore estimate that the total burden hours per year for all fund portfolios to comply with current information collection requirements under rule 12b-1, is 653,600 hours (6,536 fund portfolios x 100 hours per fund portfolio = 653,600 hours).

The annual cost of the hourly burden per fund under the rule is estimated to be \$11,135.00.⁴ This figure reflects an estimate that for each

⁴ Commission staff relied upon the SIA Report on Management & Professional Earnings in the Securities Industry 2005, and the SIA Report on Office Salaries in the Securities Industry 2005, and added an increase to cover overhead and bonuses in determining the hourly wage rates used in

fund with a rule 12b-1 plan, the following hours would be spent complying with rule 12b-1:

- 55 hours annually by fund accountants at \$47.00 per hour
(55 hours x \$47.00 per hour = \$2,585.00);
 - 10 hours annually by clerical staff and word processors at \$38.00 per hour
(10 hours x \$38.00 per hour = \$380.00);
 - 20 hours annually by compliance attorneys at \$271.00 per hour
(20 hours x \$271.00 per hour = \$5,420.00);
 - 5 hours annually by a deputy general counsel at \$550.00 per hour
(5 hours x \$550.00 per hour = \$2,750.00);
 - 10 hours annually by fund directors.⁵
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- (\$2,585.00 + \$380.00 + \$5,420.00 + \$2,750.00 = \$11,135.00)

Thus, we estimate that the total annual cost to all funds of the rule 12b-1 hour burden is \$72,778,360.00 (6,536 fund portfolios with rule 12b-1 plans x \$11,135.00 per fund portfolio = \$72,778,360.00).

the calculation of this estimate.

⁵ The estimate of the cost of the hourly burden does not include the cost of directors' time spent on complying with rule 12b-1's requirements because fund directors are not compensated on an hourly basis, and Commission staff does not believe directors' compensation varies depending solely on whether a fund has a 12b-1 plan.

We estimate that there will be an industry total of 653,600 burden hours per year at a cost of \$72,778,360.00 per year over the three year period for which we are requesting approval of the information collection burden.

13. Estimate of Total Annual Cost Burden

If a currently operating fund seeks to (i) adopt a new rule 12b-1 plan or (ii) materially increase the amount it spends for distribution under its rule 12b-1 plan, rule 12b-1 requires that the fund obtain shareholder approval. As a consequence, the fund will incur the cost of a proxy.⁶ Based on conversations with fund industry representatives, Commission staff estimates that approximately three funds per year prepare a proxy in connection with the adoption or material amendment of a rule 12b-1 plan. Funds typically hire outside legal counsel and proxy solicitation firms to prepare, print, and mail such proxies. The staff further estimates that the cost of each fund's proxy is \$30,000. Thus the total annual cost burden of rule 12b-1 to the fund industry is \$90,000 (3 funds requiring a proxy x \$30,000 per proxy).

⁶ In general, a fund adopts a rule 12b-1 plan before it begins operations. Therefore, the fund is not required to obtain the approval of its public shareholders because the fund has not yet been offered to the public.

14. Estimate of Cost to the Federal Government

Rule 12b-1 does not currently impose any costs on the federal government. The rule does not require funds to file any documents with the Commission. Commission staff may review records produced pursuant to the rule in order to assist the Commission in carrying out its examination and oversight program.

15. Explanation of Changes in Burden

The estimated annual burden hours for funds with rule 12b-1 plans increased by 24,767 hours from 628,833 hours to 653,600 hours. This is primarily due to an increase in the number of portfolios with 12b-1 plans currently operating.

The estimated total annual cost burden did not change.

16. Information Collection Planned for Statistical Purposes

Not applicable.

17. Approval to not Display Expiration Date

Not applicable.

18. Exceptions to Certification Statement

Not applicable.

B. COLLECTIONS OF INFORMATION EMPLOYING STATISTICAL METHODS

Not applicable.