

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. Purpose 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. Consultation 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 e.g., Investment Company Act Release No. 26356 (Feb. 24, 2004)

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. 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 paperwork burdens confronting the industry.

9. Payment or Gift to Respondents

Not applicable.

10. Assurance of Confidentiality

Not applicable.

11. Sensitive Questions

Not applicable.

12. Estimate of Hour Burden

Rule 12b-1 requires the board of each fund with a 12b-1 plan to (i) review quarterly reports of amounts spent under the plan, (ii) annually

(69 FR 9726 (Mar. 1, 2004)).

consider the plan's continuation (which generally is combined with the fourth quarterly review), (iii) require that the 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. 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 6,871 mutual fund portfolios have at least one share class subject to a rule 12b-1 plan.³ However, many of these portfolios are part of an affiliated group of funds known as a "mutual fund family" that is overseen by a common board of directors. Although the board must review and approve the 12b-1 plan for each fund separately, we have allocated the costs and hourly burden related to rule 12b-1 based on the number of fund families that have at least one fund that charges 12b-1

³ This estimate is based on information from the Commission's NSAR database.

fees, rather than on the total number of mutual fund portfolios that individually have a 12b-1 plan.⁴ Based on information filed with the Commission, the staff estimates that there are approximately 371 fund families with common boards of directors that have at least one fund with a 12b-1 plan.

Based on conversations with fund representatives, Commission staff estimates that for each of the 371 mutual fund families with a portfolio that has a rule 12b-1 plan, the average annual burden of complying with the rule is 425 hours. 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 whether to continue the

⁴ This allocation is based on conversations with fund representatives on how fund boards comply with the requirements of rule 12b-1. Despite this allocation of hourly burdens and costs, the number of annual responses each year will continue to depend on the number of fund portfolios with 12b-1 plans rather than the number of fund families with 12b-1 plans. The staff estimates that the number of annual responses per fund portfolio will be four per year (quarterly, with the annual reviews taking place at one of the quarterly intervals). Thus, we estimate that funds will make 27,484 responses (6871 fund portfolios x 4 responses per fund portfolio= 27,484 responses) each year.

plan.⁵ We therefore estimate that the total hourly burden per year for all funds to comply with current information collection requirements under rule 12b-1, is 157,675 hours (371 fund families x 425 hours per fund family = 157,675 hours).

We estimate that the annual cost of the hourly burden per fund under the rule to be \$100,900.00.⁶ This figure reflects an estimate that each fund with a rule 12b-1 plan would spend the following hours each year complying with rule 12b-1:

- 380 hours annually by fund accountants at \$121.00 per hour (preparing quarterly reports)
(380 hours x \$121.00 per hour = \$45,980.00);
- 10 hours annually paralegals at \$163.00 per hour (assisting with quarterly reports and annual evaluations)
(10 hours x \$163.00 per hour = \$1,630.00);

⁵ We do not estimate any costs or time burden related to the recordkeeping requirement, as funds are already required to maintain these records pursuant to other rules, and would keep these records in any case as a matter of business practice.

⁶ Salary estimates for accountants, paralegals, compliance attorneys and fund counsel is from SIFMA's Management & Professional Earnings in the Securities Industry 2008, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

- 20 hours annually by compliance attorneys at \$270.00 per hour (reviewing quarterly reports and preparing the annual evaluations) (20 hours x \$270.00 per hour = \$5,400.00);
 - 5 hours annually by a deputy general counsel at \$578.00 per hour (reviewing quarterly reports and the annual evaluations) (5 hours x \$578.00 per hour = \$2,890.00);
 - 10 hours annually by the board of directors as a whole (reviewing quarterly reports and the annual evaluations and making the necessary findings). (10 hours x \$4500.00 per hour⁷ = \$45,000.00).
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- (\$45,980.00 + \$1,630.00 + \$5,400.00 + \$2,890.00 + \$45,000.00 = \$100,900.00)

Thus, we estimate that the total annual cost to all funds of the rule 12b-1 hour burden is \$37 million (371 fund families with rule 12b-1 plans x \$100,900.00 = \$37,433,900.00).

We estimate that there will be an industry total of 157,675 burden hours per year at a cost of \$37,433,900.00 per year over the three year period for which we are requesting approval of the information collection burden.

⁷ The estimate for the costs of board time as a whole is derived from estimates made by the staff regarding typical board size and compensation that is based on information received from fund representatives and publicly available sources.

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.⁸ Based on conversations with fund 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).

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

⁸ 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.

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 decreased by 495,925 hours from 653,600 hours to 157,675 hours. This is primarily due to revised estimates the staff made based on extensive conversations with fund representatives involved in the administration of rule 12b-1 plans. In the past, the staff assumed that each fund portfolio would incur the burden of complying with the rule 12b-1's collection of information requirements individually, but the staff now understands that the collection of information burdens are typically incurred at the fund family level. Because there are significantly fewer fund families than fund portfolios with 12b-1 fees, the estimated time burden has decreased significantly. The change is also affected by an increase in the number of portfolios with 12b-1 plans currently operating, and an increase in the estimated time spent by fund accountants. 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.