

MUTUAL FUNDS

Independent Directors Tackling 12b-1 Fee

Group to Write Guidelines On Duties in Assessing Key Distribution Charge

By SHEFALI ANAND

Mutual-fund directors have long voiced concern about their responsibility to review a key distribution fee paid out of fund assets, called the 12b-1 fee. Now, an association of independent directors has prepared guidelines to help fund directors assess the fee.

The report, to be released today, follows an announcement earlier this year by top officers of the Securities and Exchange Commission that they will review the eponymous 12b-1 rule that allows this fee.

"Independent directors are very uncomfortable with the system as it is now," says David Smith, executive vice president of the Mutual Fund Directors Forum. Its report aims to provide directors a guide to fulfill their fiduciary duty, says Mr. Smith.

Rule 12b-1 was adopted in the 1980s when mutual funds were facing net redemptions, and it allowed the use of fund assets to pay for distribution and thus help funds grow. Over the years, however, the use of this fee has changed, and it is now primarily used either as an alternative to front-end loads to compensate intermediaries like brokers, or for payment of services like administration and shareholder services.

The rule requires that a majority of the fund's independent directors assess and approve the fund's 12b-1 plan every year with a goal to ensure that the money ultimately benefits fund shareholders.

But directors say it's tough to discern these benefits, because for one thing, the money is often bundled together to pay for several services. It can be difficult to assess what proportion of the fee is going to which service, says Mr. Smith.

Directors also are limited in their say of how much 12b-1 fee should be paid. For instance, once the fund adviser chooses a particular distribution channel, such as a broker-dealer, the 12b-1 fee to be paid is either decided by the broker or the marketplace.

"We sort of have no control over that," says John A. Hill, an independent trustee at mutual-fund giant Putnam Funds.

The SEC had originally listed some factors that a board may consider while considering this fee, but experts say those factors aren't very relevant in today's industry environment. "How does a director fulfill the responsibility to fund shareholders, with vague, outdated guidance?" says Jay Baris, a lawyer at Kramer Levin Naftalis & Frankel LLP.

The forum's report aims to help provide some best practices. Among its various rec-

ommendations, the report advises that directors carefully assess the fund's overall distribution plan and understand where 12b-1 plan fits into that. They should also look at factors such as the fund's share-class structure and whether the costs associated with the funds' distribution are justified by competitive conditions.

The forum next plans to prepare recommendations for the SEC on how to improve the 12b-1 rule. Mr. Smith says there have been a range of proposals to tackle this, such as taking directors out of the 12b-1 review process altogether, to merging it with management fees.

Some, like Mr. Hill, would prefer to eliminate it totally.

"I don't think it's the right way to finance distribution because it's not clear and it lacks transparency," says Mr. Hill.

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