E*TRADE FINANCIAL

May 11, 2004

Mr. Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549-0609

Re: Prohibition on the Use of Brokerage Commissions to Finance Distribution (File No. S7-09-04)

Dear Mr. Katz:

E*TRADE Financial Corporation ("E*TRADE") appreciates the opportunity to express its views on the Securities and Exchange Commission's recent proposal to amend Rule 12b-1 under the Investment Company Act of 1940.[1] E*TRADE welcomes the opportunity to respond to the Commission's request for comments on whether the Commission should propose additional changes to Rule 12b-1 to address issues that have arisen under the rule. E*TRADE agrees with the Commission's observations in the Proposing Release that the provisions of Rule 12b-1 "may not address a number of matters that today face funds and fund shareholders,"[2] and that the mutual fund marketplace has changed significantly since the rule was adopted in 1980.

E*TRADE is a diversified financial services company that offers a wide range of financial products and services. E*TRADE's core strategy is to create value for customers, and competitive advantage, by using technology to provide brokerage, banking and lending products, primarily through electronic delivery channels. E*TRADE offers retail brokerage services through E*TRADE Securities LLC, a wholly owned subsidiary of E*TRADE and a registered broker-dealer.

E*TRADE offers both proprietary and non-proprietary mutual funds to retail investors. Our platform provides investors with the opportunity to select from nearly 6,000 mutual funds representing over 250 fund families. To assist potential investors in their selection process, E*TRADE provides them with a variety of search tools, detailed fund fact sheets, and on-line access to prospectuses, statements of additional information and shareholder reports. In addition to receiving service fees from funds and their affiliates, E*TRADE is compensated for the services it performs through the receipt of Rule 12b-1 fees. E*TRADE believes Rule 12b-1 continues to serve a valid purpose by providing an important means of facilitating the offering of mutual fund supermarkets, thereby enabling millions of investors to conveniently access thousands of funds across the entire spectrum of available asset classes.

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[1] SEC Release No. IC-26356 (Feb. 24, 2004) ("Proposing Release"). We have previously spoken to the Commission staff about the timing of delivery of our comment letter.

[2] See Proposing Release, text accompanying footnote 62.

E*TRADE recently created a rebate program (the "Program") to pass along the efficiencies of E*TRADE's business model to our customers who purchase and hold mutual fund shares through our platform. Under the Program, E*TRADE will pay to its eligible customers an amount equal to 50% of the revenues E*TRADE receives from Rule 12b-1 fees and service fees. For the sake of simplicity, the amount to be paid under the Program is expressed as a percentage of Rule 12b-1 fees and service fees. In economic reality, the amount may be paid out of these fees, out of E*TRADE's other financial resources, or some combination thereof. E*TRADE believes the Program will foster competition in the marketplace and thereby offer the investing public, at lower costs, more choices in the manner in which they purchase mutual funds. The long-term effect of these lower costs should be to lower the amount of Rule 12b-1 fees paid throughout the industry.

E*TRADE believes that rather than rescinding Rule 12b-1, the Commission should amend Rule 12b-1 to strike a reasonable balance between a broker-dealer's need to be compensated for its services in connection with the distribution and ongoing servicing of an investor's holdings of mutual fund shares and encouraging marketplace competition that may help reduce the costs associated with mutual fund investing. Specifically, E*TRADE recommends that the Commission amend Rule 12b-1 to provide a safe harbor that can encourage broker-dealers to "rebate" a portion of their Rule 12b-1 fees to their customers.[3] We have included a draft amendment to Rule 12b-1 that we believe would achieve these goals as an appendix to this letter.

We believe the creation of a safe harbor would be an appropriate Commission action to encourage marketplace competition. Providing such a safe harbor in Rule 12b-1 would be in the best interest of investors for a couple of reasons. First, a safe harbor would increase marketplace competition by encouraging broker-dealers to offer their customers more services for less cost in an effort to compete with other broker-dealers. The investing public would be the direct beneficiaries of such increased competition. Second, such increased competition is likely to benefit fund shareholders as more investors purchase shares of a fund offered through a broker-dealer rebating Rule 12b-1 fees, thereby increasing the assets of the fund. As assets in a fund increase, the fixed costs of the fund are spread over a larger asset base thereby lowering costs for individual shareholders.

[3] E*TRADE does not believe a broker-dealer is subject to Rule 12b-1 when rebating Rule 12b-1 fees because it is the broker-dealer and not the fund that is making payments to its customers.

E*TRADE believes that the Commission can facilitate competition in the marketplace, and thereby reduce the cost of mutual fund investing, by amending Rule 12b-1 as described above.

Sincerely,

/s/
Jarrett Lilien
President and Chief Operating Officer
E*TRADE Financial Corporation

cc: Paul F. Roye, Director
Division of Investment Management

Appendix

Proposed Amendment to Rule 12b-1
Distribution of Shares of Registered Open-end
Management Investment Company

Rule 12b-1 under the Investment Company Act of 1940 is amended by adding at the end the following new subsection:

"(h) **Safe Harbor for Certain Broker Payments to Customers** –

"(1) **Permitted Payments**. – A payment by a broker to a customer that owns securities issued by a registered open-end management investment company shall not constitute a direct or indirect violation of Section 12(b) or Rule 12b-1 there under, by such investment company, such company's principal underwriter, or any dealer with respect to such securities, and shall not cause the investment company's board of directors or any member thereof to be in breach of any fiduciary responsibility under state or federal law, common law, or otherwise, if:

"(A) Such payments are made solely out of the broker's own resources, which may include, but are not limited to, any proceeds from any fees or amounts that otherwise have been lawfully paid to the broker (or any affiliated person of the broker) by such investment company or by any other person for distribution, administrative, or other services in connection with such investment company or its securities or security holders;

"(B) the broker advises each customer of the manner in which the timing and amount of any such payments to the customer in respect of any such investment company securities owned by the customer will be determined, including information about any rights that the broker reserves to terminate such payments and whether the customer is entitled to receive advance notice of any such termination;

"(C) the broker establishes and maintains procedures that are reasonably designed to ensure that all of the broker's customers that own the same registered open-end management investment company securities will receive uniform treatment with respect to such payments; and

"(D) all such payments to customers are made in conformity with such procedures established by the broker, as then in effect.

"(2) **Construction.** – The fact that the amount or timing of any such payment by a broker to its customer may be based, wholly or in part, on the amount or timing of fees or amounts paid to the broker, as described in subsection (1)(A) above, shall not be construed to indicate that such payments by a broker are not paid solely out of the broker's own resources.

"(3) **No Presumption.** – Nothing in this subsection (h) shall be deemed to raise any presumption or inference that any payment to a customer made by a broker that is not in compliance with this subsection (h) involves a violation by the broker, a fund, or any other person of any legal requirement or duty."