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May 10, 2004

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

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

Dear Mr. Katz:

MFS Investment Management ("MFS") appreciates the opportunity to express its views on the Securities and Exchange Commission's (i) recent proposal to amend Rule 12b-1 (the "Rule") under the Investment Company Act of 1940, as amended (the "1940 Act"), to prohibit mutual funds from recognizing the distribution of their shares with brokerage commissions, and (ii) request for comments on whether the Commission should propose additional changes to Rule 12b-1 to address other issues that have arisen under the Rule, or propose to rescind the Rule.[1]

By way of background, MFS is an investment adviser registered with the Commission under the Investment Advisers Act of 1940, as amended. MFS serves as an investment adviser to each of the funds included within the MFS Family of Funds, to various other open-end and closed-end registered investment companies, to various offshore funds and to substantial private institutional accounts. The MFS organization has been engaged continuously in the investment management business since it began operations in 1924 with the creation of the first mutual fund, Massachusetts Investors Trust. MFS now manages approximately $140 billion on behalf of over six million investors worldwide.

MFS strongly supports the Commission's proposed rule amendment to prohibit mutual funds from allocating brokerage commissions to recognize brokers for the distribution of fund shares. We suggest, however, that the proposed rule amendment be revised or clarified in several respects and, in particular, support the recommendations regarding the amendment set

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[1] SEC Release No. IC-26356 (Feb. 24, 2004); 69 Fed. Reg. 9726 (Mar. 1, 2004) ("Proposing Release").

forth in the comment letter, dated May 10, 2004, filed by the Investment Company Institute (the "ICI") with the Commission.

We also agree that certain of the provisions of the Rule and the Commission's guidance regarding the Rule should be revisited. We support modernizing the Rule to make certain of its provisions more consistent with current distribution practices that have long been accepted by the mutual fund industry, independent directors to mutual funds and the Commission's staff. Contrary to views expressed recently by some members of Congress and the press, we believe that the development of alternative distribution arrangements that have been made possible by the Rule have significantly benefited shareholders. Providing flexibility in distribution arrangements has helped to foster the growth of the mutual fund industry, which has enabled investment companies to realize economies of scale in investment operations and expenses and management companies to offer investors a broader array of investment products. The Rule has also enabled the mutual fund industry to offer investors a variety of options for compensating their broker for the broker's services in connection with investments in mutual funds. We believe that amendments to the Rule that better reflect market practices would serve to improve investor protection through enhanced disclosure and provide clearer guidance to mutual fund boards in evaluating the costs and benefits of distribution plans.

We do not, however, believe that the Commission's proposal to deduct distribution costs from shareholder accounts is an appropriate way to reform industry practices. In addition to creating substantial administrative costs and potential tax burdens for shareholders, this approach would not provide transparent information about distribution costs at the relevant time, *i.e.,* when fund shares are purchased. As an alternative, MFS proposes that the Commission require new disclosures that would allow investors at the time of purchase to compare the present value of distribution costs for different classes of fund shares over a range of holding periods. In our view, this disclosure-based approach is much more likely to benefit investors than a requirement that distribution-related expenses be deducted in the future from shareholder account balances.

MFS does not believe that the elimination or significant modification of the Rule or the means by which funds finance the distribution of their shares is prudent or necessary. We urge the Commission not to make fundamental changes of this nature. Nevertheless, if the Commission feels compelled to do so, we caution the Commission that implementation of any revisions of this nature be phased in over a sufficient period to allow the mutual fund industry to adapt to the new regime.

While MFS agrees with many of the comments raised in the ICI's comment letter, we would like to highlight certain key points which we have set forth in Section I and II below and have offered two additional proposals related to distribution of fund shares in Section III below. We believe that these additional proposals would be of great benefit to investors.

I. Proposed Ban on Directed Brokerage Arrangements

MFS strongly supports the proposed prohibition. Indeed, MFS adopted a new internal policy in November 2003 which provides that MFS shall not consider sales of fund shares as a factor when selecting broker-dealers to execute portfolio transactions for the MFS Funds.

II. Comments on Further Amendments to Rule 12b-1

A. Benefits to Shareholders from Rule 12b-1

Given the many developments in fund distribution practices since the Rule was adopted in 1980, an updating of the Rule to address these developments is timely and prudent. The Rule, as the mutual fund industry and the staff of the Commission have applied it, has fostered significant developments over the past two decades in the manner in which shareholders can elect to compensate brokers for their services in connection with the purchase of shares of mutual funds, *i.e.,* through front-end, back-end and "level load" sales charges. If investors are provided with sufficient information to make informed decisions, we believe that offering shareholders more options is beneficial to the investing public. Well-informed shareholders should be the goal of both the Commission and the mutual fund industry. Fees under the Rule are used in part to help make independent advice available to shareholders on an ongoing basis. Asset-based fees enabled mutual funds to compensate broker-dealers and other investment professionals for providing ongoing advice to fund investors regarding whether continuing to hold a specific fund remains consistent with changing market conditions and the investor's financial objectives. Asset-based fees have also allowed mutual funds to offer a broad range of share classes that meet the needs of different investors and distribution channels. As noted in the ICI's comment letter, the changes in fund distribution practices enabled by the Rule have led to greater competition in the industry, more investor choice, and significantly lower distribution costs.

B. Recommendations for Reform of Rule 12b-1

MFS believes that the Commission should amend the Rule to provide clearer guidance to fund directors as to the factors that they should consider in adopting or renewing a Rule 12b-1 plan. In this regard, we believe that, in circumstances where an asset-based sales charge is being used as a means of financing the commission paid to the selling broker (such as the typical Class B shares), the Rule should recognize that the distribution services have been provided at the time of sale and the ongoing payments under the Rule are permitted in recognition of those past services. The procedural requirements of Rule 12b-1 should be modernized and the need for annual renewal re-examined.

As a general matter, MFS supports the recommendations in the ICI's comment letter that the Commission should consider various changes to the current board review and approval process in order to ensure an appropriate level of board oversight and that directors consider appropriate factors in approving the implementation of a Rule 12b-1 plan.

C. Deducting Distribution Costs from Shareholder Accounts

The Proposing Release requests comment on whether the Commission should "refashion" the Rule so that fund service providers would be required to deduct distribution-related costs directly from shareholder accounts rather than from fund assets. MFS strongly disagrees with this proposal because it would involve enormous costs that ultimately would be borne by funds and fund shareholders and would have few, if any, benefits for funds and their shareholders. In addition, if ongoing distribution expenses are not charged at the fund level, there is the potential for a weakening of the oversight role of the independent directors and for fund companies or distributors to develop a complex array of shareholder account-based distribution fees. We believe that it would open the door to disparate treatment of similarly situated shareholders.

We do not believe that deducting distribution costs at the shareholder level would provide any of the benefits suggested by the Proposing Release and would potentially have significant negative consequences for shareholders. We agree with the assessment in the ICI's comment letter that requiring funds to deduct distribution-related costs directly from shareholder accounts would cause funds and their shareholders to incur: (1) substantial transfer agent and accounting costs for administering and monitoring individual shareholder accounts; (2) substantial costs (in terms of both dollars and staff time) associated with developing and implementing the systems necessary to support these functions; (3) significant bookkeeping burdens and accounting problems for fund distributors; and (4) adverse tax consequences and increased recordkeeping burdens for fund shareholders. Fund complexes also would incur substantial costs associated with educating shareholders and financial intermediaries about the new cost deduction structure and its effect on shareholder accounts. Again these costs will ultimately be borne by funds and fund shareholders.

An arrangement whereby distribution costs are charged at the account level may also have many unintended consequences. For example, mandatory deductions from shareholder accounts likely would be effected through redemptions of fund shares, which is a taxable event. Shareholders would incur tax liabilities for gains when not actually receiving any distributions (or would realize losses) and would bear added tax-related recordkeeping burdens. For tax-deferred accounts, such as pension plans, IRAs and annuities, mandatory redemptions could result in taxable distributions to shareholders and/or loss of tax-deferred status for the entire account.

The Commission cites in the Proposing Release a number of advantages of deducting distribution fees at the shareholder account level. We do not believe that any of these advantages withstand closer scrutiny. First, the Proposing Release states that deducting distribution fees at the shareholder account level would be more transparent to investors. We agree that it is important for mutual funds to communicate more effectively to investors the distribution costs that shareholders are bearing. However, we do not agree that deducting fees from shareholder accounts is the most efficient or transparent means of achieving that goal. The Proposing Release suggests that greater transparency and investor awareness of distribution costs would result from the deduction on a periodic basis of distribution costs from the shareholders account and the disclosure of such periodic deductions on the account statement. By this means, the distribution costs that an investor bears over time would be disclosed in small increments over a number of years. Each individual payment may provide a distorted picture of the overall distribution costs being incurred by an investor and the investor will not obtain a clear illustration of the investor's long-term costs. Rather than this fragmented means of communicating distribution costs, we believe that enhanced prospectus disclosure is a clearer and less expensive avenue for providing meaningful disclosure to investors. We have recommended in Section III.A. of this letter one means of providing such enhanced disclosure.

Second, the Proposing Release notes as another advantage of account-based deductions that existing shareholders will not incur costs of selling shares to new shareholders. This advantage ignores one of the fundamental premises behind the initial adoption of the Rule. By attracting new investors, a fund will hopefully achieve economies of scale in its investment program and cost structure, which will benefit both existing and new shareholders. This cost avoidance rationale would also appear to significantly draw into question the ability of no-load funds to use the Rule to pay for advertising and other distribution activities.

The third advantage cited in the Release is that long-term investors will not be paying more than their fair share of distribution expenses. Again, we believe that this advantage, and the assertion that this methodology would eliminate potential conflicts of interest in the distribution of fund shares, is illusory. Currently, a Class A shareholder, for example, pays a front-end sales load and typically a Rule 12b-1 fee, most or all of which consists of a 0.25% service fee. The front-end sales load is already charged at the shareholder level. The Rule 12b-1 fee for Class A is primarily used to compensate intermediaries for ongoing client account servicing. These services would continue to be needed. Consequently, shifting the fee to the shareholder account level would have no economic advantage to a shareholder. Similarly, with Class B shares, the CDSC is already deducted at the shareholder account level. Moving the Rule 12b-1 fee to the shareholder account level would not result in any economic benefit to a shareholder.

We are concerned that moving these expenses to the shareholder account level may lead to a proliferation of different fee arrangements depending upon the distribution channel and the leverage of an individual shareholder. The ability of different distribution channels or shareholders to negotiate special deals would be a negative development for the fund industry. As with the management fee, we believe that one of the strengths of the mutual fund industry is that similarly situated shareholders are treated equally.

Finally, removing the fee as a fund expense would appear to negate the role of the independent directors in reviewing distribution fees. In fact, the Proposing Release seems to contemplate a reduced role for independent directors as it notes that the proposal would "free their time to address more significant matters." Consequently, the proposal is at odds with the role under the 1940 Act of the independent directors as the fiduciary watchdogs of shareholder interests.

D. Any Material Modification to the Rule Should Be Phased in Gradually

While we encourage the Commission to modernize the Rule and discourage any material recasting of the Rule, we recognize that the Commission may decide to adopt a material change in the manner in which mutual funds are sold. In the event that the Commission adopts such an approach, we urge the Commission to phase in any changes over time. Distribution arrangements are an essential component of the management of an investment company. Any change in a rule that is critical to the ability of the mutual fund industry to serve its shareholders should be a very deliberative process and provide for adequate time for adjustment by investment companies, the investing public and service providers. A fundamental shift in the means of payment for distribution expenses would require significant additional costs. It is critical that any fundamental change is accompanied by a sufficient phase-in period to allow fund companies and the boards of mutual funds to evaluate the best means of addressing the new requirements. Any fundamental change could also potentially necessitate substantial shareholder education.

III. Additional Proposals

A. New Disclosure of Present Value of Aggregate Rule 12b-1 Fees and Sales Charges

As outlined above, one of the flaws in the Commission's proposal to deduct distribution expenses from shareholder accounts is that the proposal would not provide investors with transparent and useful information at the critical moment when the investor is making an investment decision. As an alternative, MFS recommends that the Commission require a new form of present value disclosure of distribution expenses that would assist investors in comparing the distribution costs of different fund classes over a range of holding periods.

As the mutual fund industry has evolved over the past few years, investors are being presented with a wide range of choices in how to pay for the cost of distributing mutual fund shares. In general, this wide range of choices is beneficial to investors, but it also presents certain challenges. Some fund classes charge front-end sales charges ("FESCs"), which are paid immediately. Others charge Rule 12b-1 fees, which are imposed over time. Still others impose contingent deferred sales charges ("CDSCs"), which are charged in the future but only if shares are redeemed within a certain period of time. Many fund classes impose a combination of these and other fees. Simply knowing the differences in fee structures does not necessarily tell an investor which fund class has the lowest distribution costs. Investors also need to consider their expected holding period and, equally important, know how to compare distribution expenses paid today with expenses paid in the future. Many investors are not able to make time-value of money comparisons and may underestimate the true cost of periodic expenses charged in the future. Better disclosure could help correct this.

As explained in more detail below, MFS recommends that the Commission amend its disclosure rules for distribution costs to assist investors in comparing the estimated costs of distribution expenses for different classes of fund shares. This approach would require disclosure of the present value of distribution costs for different classes of fund shares for a range of holding periods. The approach is not unique. The Truth-in-Lending Act, for example, requires consumer lenders to report the cost of borrowing in a common metric that facilitates comparisons among loans with different combinations of up-front fees and interest rates over different periods of time. Much more effectively than fee formulas, these present value estimates would give investors a clear sense of the relative distribution costs of different fund classes for different holding periods.

Funds currently include in their prospectus an example that illustrates the overall expenses that an investor will pay over time. In these tables, it is not possible to separately identify the amount of distribution-related expenses that a shareholder would incur. MFS recommends that funds be required to include an additional table in their prospectus that would separately illustrate the present value of the aggregate costs to a shareholder of FESCs, Rule 12b-1 fees, and CDSCs (collectively referred to as "Distribution Costs") in each share class offered by the fund to retail investors.[2] This table would permit investors to compare more easily the varying "actual" Distribution Costs of each share class of the fund available to retail investors. Read in conjunction with the expense example required under Form N-1A, this Distribution Cost table would provide an investor with a clearer understanding of the different types of expenses that they will incur over time. For each class of shares offered by the fund to retail investors**,** the table would include the present value of the aggregate Distribution Costs that would be borne by a typical shareholder, assuming that the shareholder purchased his or her shares and redeemed them at the end of each year in a ten-year period.

In order to promote standardized present value reporting across all funds and to enable potential investors to compare Distribution Costs across classes and competing funds, we recommend that the Commission mandate certain assumptions and requirements, such as the following:

1. Assume an initial purchase of $10,000, the reinvestment of all distributions, no other additional share purchases, and no redemptions (except for a complete redemption at the end of each stated period).
2. Assume an annual investment return of 5%.
3. For each year, show the present value of Distribution Costs that would be borne by the account from the date of initial investment through the end of the applicable period.
4. The Commission should mandate a standardized methodology for computing present value. For example the Commission could require all funds to use as the discount rate the 10-year U.S. Treasury bond rate published as of the first business day of the calendar year in which a prospectus is published.
5. Require that funds include appropriate narrative disclosure accompanying the table that briefly describes the significant assumptions applied when calculating the Distribution Cost data.

An example of a table, which could be included in a prospectus, is attached as <u>Appendix A</u> to this letter.

B. Limiting Excessively Large Purchases of Class B Shares

Many funds offer a variety of share classes that have different cost and pricing structures. The suitability of the alternative classes will differ based upon a number of factors, including the availability of sales load waiver categories, the amount being invested, the expected duration of the investment and the investor's short-term outlook for the market. Many funds offer both Class A shares, which typically have a FESC, no CDSC and a relatively low Rule 12b-1 fee, and

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2 To facilitate more accurate class comparisons, consideration should be given to including non-Rule 12b-1 shareholder servicing costs (*e.g.*, third party administration, network fees, omnibus account charges, etc.) in the present value comparison.

Class B shares, which have no FESC, a CDSC that applies for several years, and a relatively high Rule 12b-1 fee. Many Class A shares offer a FESC schedule that offers discounts for successively larger investments (commonly referred to as "breakpoints"), with the initial breakpoint and reduced FESC beginning with investments of $50,000 or $100,000.

In cases where an investor intends to make a large investment and therefore would be eligible to pay a reduced FESC under the Class A breakpoint schedule, Class A shares typically would be more appropriate than Class B shares. As a matter of good business practice, many fund distributors and broker-dealers have adopted internal guidelines that are designed to prevent Class B shares from being sold to large investors for whom Class A shares would be more suitable. However, these guidelines and practices vary in their substance and application throughout the industry.

In recognition of industry concerns about inappropriate Class B share sales to large investors, MFS recommends that the Commission provide additional guidance to fund directors. The guidance would require fund directors to: (i) consider adopting fund policies barring inappropriately large sales of Class B shares; and (ii) consider as a starting point, when designing such policies, that investors planning to invest an amount that would make them eligible for at least the first breakpoint reduction on Class A shares should be sold Class A shares, not Class B shares, absent some extraordinary circumstance.

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We appreciate the Commission's consideration of our comments. If you have any questions or need additional information, please contact me at (617) 954-5707, Jeffrey N. Carp at (617) 954-5747, or Robert Burns at (617) 954-5845.

Sincerely,

/s/ Robert C. Pozen

Robert C. Pozen
Chairman

Appendix A – Sample Disclosure Table for Distribution Costs

When you invest in the fund, you will pay some combination of a front-end sales charge, Rule 12b-1 distribution fees and a contingent deferred sales charge (collectively, "Distribution Costs"). The amount of Distributions Costs you will pay depends on which class of shares you purchase and the length of time you hold the shares. The table below will help you understand which class of fund shares is likely to have the lowest Distribution Costs for your investment.

The table shows the "present values" of estimated Distribution Costs. Present values are a good way to compare Distribution Costs across share classes because present values represent an estimate of the amount of money you would need to set aside today in order to pay for the Distribution Costs associated with your investment, taking into account both the amount of Distribution Costs you would pay and the timing of those payments. Generally speaking, you should choose the share class with the lowest estimated Distribution Cost for the length of time you expect to hold your investment.

The Table reflects the schedule of Distribution Costs described elsewhere in this Prospectus.* In addition, we have assumed that: a) you invest $10,000 in the fund for the time periods shown, b) you reinvest all dividends and distributions, c) your investment has a 5% return each year, and d) you redeem all of your shares at the end of the period. Although your actual Distribution Costs may be higher or lower (depending, among other things, on how long you actually hold the shares), under these assumptions the estimated present value of your Distribution Costs would be:

Estimated Present Value of Distribution Costs on a $10,000 Investment										
Holding Period	1 Year	2 Years	3 Years	4 Years	5 Years	6 Years	7 Years	8 Years	9 Years	10 Years
Class A	$599.20	$623.20	$646.99	$670.57	$693.95	$717.13	$740.12	$762.90	$785.49	$807.89
Class B	$494.01	$578.22	$571.94	$658.20	$661.35	$670.48	$685.16	$776.83	$799.38	$821.74
Class C	$200.54	$203.77	$303.20	$401.03	$497.28	$591.98	$685.16	$776.83	$867.03	$955.77

So, for example, if you purchased Class B shares and held your investment for five years, the estimated present value of your Distribution Costs would be $661.35.

* Class A has a Front End Sales Charges (FESC) of 5.75 %, an annual 12b-1 Fee of 0.25 %, and no Contingent Deferred Sales Charge (CDSC) Class B has no FESC, an annual 12b-1 Fee of 1.0%, and a CDSC of 4.0%in Years One and Two, 3.0% in Years Three and Four, 2.0% in Year Five, 1.0% in Year 6, and 0.0% thereafter. Class C has no FESC, an annual 12b-1 Fee of 1.0%, and a 1.0% CDSC in Year One and 0.0% thereafter. We have assumed a discount rate of 4.5% per annum. The discount rate represents the assumed rate of return that you would realize if you were able to invest the money you would need to set aside today in order to finance the Distribution Costs associated with your investment.

Under the assumptions described above, this table indicates that Class C shares would have the lowest estimated Distribution Costs if you were going to hold your investment for less than seven years. If you were going to hold your investment for seven or eight years, the estimated Distribution Costs for Class B and Class C shares would be the lowest. If you were going to hold your investment for nine years or more, Class A shares would have the lowest estimated Distribution Costs.

You are cautioned that overall return on your investment depends on a number of factors in addition to Distribution Costs. Selecting the class of shares with the lowest expected Distribution Costs does not guarantee you the share class with the highest rate of return.

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