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OFFICE OF THE SECRETARY

Jonathan G. Katz, Esquire
Securities & Exchange Commission
450 Fifth Street
Washington, DC 20549-0609

Re: File No. S7-09-04

Dear Mr. Katz:

The SEC is undertaking a review of 12b-1 fees and the preliminary conclusions appears to be headed towards a recommendation to eliminate them. If 12b-1 fees are eliminated, there will be severe consequences for broker-dealers, registered representatives, and the investing public.

The advent of 12b-1 fees came about over 20 years ago as the mutual fund industry embarked upon a series of pricing changes. It began with a reduction of front-end loads and has evolved to the multi-class share structure for individual and institutional investors that we find today. From a consumer standpoint, the adoption of 12b-1 fees has given them more choices, a reduction in costs, and increased advice and service.

In the case of Class A shares, today's investors enjoy a reduction in the up-front costs of purchasing shares. For example, prior to the adoption of 12b-1 fees, investors paid front-end sales charges of 7 – 8% for equity mutual funds. Compare this with a typical fund in today's world. A front-end load of 4.75% is commonly found with a 12b-1 fees of .25%. Today's investor saves 2.25 – 3.25% of their investment in reduced commissions with more of their money being put to work in the fund. Furthermore, they could pay 12b-1 fees for 9 – 13 years on their original investments before reaching a total expense of 7 – 8%. Industry statistics indicate that redemption rates are in the 20% range, which results in a holding period of five years.

Concurrent with the reduction in front-end loads, many funds also eliminated sales charges on reinvested dividends. A number of funds had this provision because they wanted to reward representatives for the ongoing advice, support, and service provided to the investor.

This is an important theme. We must recognize that the purchase of a mutual fund is merely a transaction. It is the result of financial advice. The financial advice rendered may cover the entire gamut of the investor's needs or be limited to a specific life event (i.e., retirement). The result of the advice is to purchase, but the job of the investment professional doesn't end with the transaction.

The advent of 12b-1 fees created an incentive for financial advisors to provide ongoing advice and service to their clients. There was an alignment of the customer's interests with the registered rep's. The financial advisor has an incentive to keep the customer's interests and needs satisfied by providing ongoing advice and service. Advice does not end with the purchase transaction. Clients need someone to answer questions during times of market turmoil. They need help in re-evaluating their risk tolerance and asset allocations. Guidance is necessary when life events cause a new financial need or a change in course. By growing their base of assets under management and the resulting 12b-1 fee income stream, financial advisors have been able to create the infrastructure needed to provide the ongoing advice and service to their clients.

We should not underestimate the cost and the value of the network of financial advisors serving the investing public. They have invested in systems and staff that allow them to provide their clients the support they need to achieve financial success. We cannot assign a price to the value of advice. We can cite some examples that demonstrate value. For example, industry statistics have historically shown that investors with financial advisors tend to hold their mutual fund shares for longer periods. The do-it-yourself investor often makes hasty moves at the wrong time. How many dollars were saved in October 1987 when advisors told their clients not to panic and sell at the bottom of the market?

Movement to fee-based programs would be a possible outcome of eliminating 12b-1 fees. This would not be in the best interests of all consumers because of increased costs. If we compare a 12b-1 fee of .25% to the typical wrap-fee of 1 – 2%, investors using retail mutual funds and a financial advisor truly have a cost efficient arrangement.

The proposal is not financially feasible. One of the key aspects of Class B share pricing is an enhanced 12b-1 fee (when compared to an A share) that enables the product to be viable. The distributor pays front-end commissions to selling reps when a B share is sold. All of the investor's funds are put to work in the mutual fund. The distributor has essentially advanced commissions that it will recover by way of the 12b-1 fees. Often, the funds to pay these up-front commissions come from bank loans. Elimination of 12b-1 fees would cause financial havoc in every fund complex where B shares have been sold.

In addition, elimination of 12b-1 fees would result in the end of alternative share classes. Class B and C shares would no longer be financially viable. It appears that the Commission and the NASD have concerns about the suitability of these share classes. However, they should be reminded that people want choices and they should be allowed to purchase an alternative share class, even if more expensive, it that is their choice. Class B and C shares created choices where the investor did not have to pay an up-front commission. This eliminated an emotional obstacle to investing for many consumers. It

is no different than a consumer making a decision on buying or leasing a car. Very often the more expensive option is chosen because that is what the consumer is comfortable with.
However, even if they bought shares that may cost more to own, the key is that they made appropriate choices to meet their financial needs. They are better off by making the investment than by sitting on the sidelines paralyzed by an emotional obstacle concerning commissions.

Moreover, many institutional share classes would also be eliminated causing an upheaval in the employee benefits marketplace. The 12b-1 fees are used to cover a variety of costs (i.e. recordkeeping) that would be redirected to either the employer or the employees. In the end, someone has to pay for the expenses. At best, the 12b-1 fees could be phased out over a period of years.

The real result of elimination of 12b-1 fees would be a step backwards for our industry. We would revert to a single class of mutual funds shares with front-end loads. The incentives and the funds to provide ongoing advice and service would disappear. New incentives to churn customer assets would be created and more dollars would go to fee-based programs that are more expensive.

If the concerns are about disclosure and investor understanding, let's focus on that. Make prospectuses easier to read, help educate the investing public, and consider the value of ongoing advice and service in helping investors meet their financial goals and obligations.

We cannot turn back the clock on 12b-1 fees. Products have been created that utilize them to make the products financially viable. Firms and representatives rely on these income streams to support the infrastructures they have built to serve the investing public. Action to undo what has been built over the past 20 plus years will not benefit anyone and will cause significant turmoil in the industry.

Sincerely,

Nicholas H. Phelps