Use of Rule 12b-1 Fees by Mutual Funds in 1999

Rule 12b-1 of the U.S. Securities and Exchange Commission allows a mutual fund, under specified circumstances, to use fund assets to pay for distribution expenses. Since the adoption of the rule in 1980, mutual funds have used 12b-1 fees, often in combination with contingent-deferred sales charges, as an alternative to front-end sales loads for compensating sales professionals for assistance provided to purchasers of fund shares. Other uses of 12b-1 fees have included advertising, sales materials, and other activities involving the marketing of fund shares to prospective investors. Finally, mutual funds have used 12b-1 fees to pay for administrative services provided by third parties to existing fund shareholders.

This issue of Fundamentals documents the various uses of 12b-1 fees. To this end, the Investment Company Institute (ICI) surveyed its members with 12b-1 plans, asking each to report the dollar amount of 12b-1 fees paid by their funds in the most recent twelve-month accounting period and to allocate those fees among the following three uses:

- **Compensation of broker-dealers and related expenses**, including payments made to broker-dealers for sale of fund shares; reimbursements to the fund’s distributor for financing charges arising from advances made to broker-dealers for the sale of fund shares; and compensation of in-house personnel;

- **Administrative services**, including compensation to third parties for recordkeeping and other services provided to current fund shareholders; and

- **Advertising and other sales-promotion activities**, including expenses for the printing and mailing of prospectuses and sales materials to prospective investors.

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At the end of 1999, 242 of the ICI’s 434 member complexes had at least one fund with a 12b-1 plan. Of the 242 members with 12b-1 plans, 95 members (39 percent) responded to the survey. Survey respondents accounted for 52 percent of all mutual fund share classes with 12b-1 plans and for 69 percent of assets in all share classes with 12b-1 plans (Figure 1). Because 12b-1 fees are computed as a percentage of assets, the high asset coverage ensures that the sample of survey respondents accounts for the majority of 12b-1 fees.

The survey results show that covering the costs of compensating broker-dealers for the sale of fund shares and related expenses is the most important use of 12b-1 fees. For all survey respondents, expenses related to this type of distribution activity accounted for 63 percent of 12b-1 fees in the most recent twelve-month reporting period (Figure 2). Thirty-two percent of 12b-1 fees reflected in the survey paid for expenses associated with administrative services provided to existing shareholders by third parties. Finally, use of 12b-1 fees to pay for advertising and other sales-promotion activities was minor, representing only 5 percent of 12b-1 fees.

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**figure 1**

**Mutual Fund Share Classes with Rule 12b-1 Plans**  
**December 31, 1999**

<table>
<thead>
<tr>
<th>All share classes with 12b-1 plans¹</th>
<th>8,293</th>
<th>$2,685</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share classes with 12b-1 plans among survey respondents²</td>
<td>4,285</td>
<td>1,854</td>
</tr>
</tbody>
</table>

**Memo: Ratio of survey respondents to all share classes**

| (percent) | 52% | 69% |

¹Investment Company Institute.

²ICI Survey of 95 mutual fund complexes having at least one fund with a 12b-1 plan.

Note: Variable annuities included.

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**figure 2**

**Use of 12b-1 Fees, 1999**  
(percent of total 12b-1 fees)

- Compensation of Broker-Dealers and Related Expenses: 63%
- Advertising and Other Sales Promotion Activities: 5%
- Administrative Services: 32%

Source: ICI survey of 95 mutual fund complexes having at least one fund with a 12b-1 plan.

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²At the end of 1999, 56 percent of the 15,264 share classes of all mutual funds had 12b-1 plans, and 40 percent of the $6.8 billion of assets in all mutual funds were in share classes with 12b-1 plans.

³Differences in reporting periods potentially introduce an inconsistency in aggregating the uses of 12b-1 fees reflected in the survey. However, the reporting periods and 12b-1 fees are highly concentrated. Seventy-three percent of the reporting periods, accounting for 79 percent of 12b-1 fees, ended in December 1999. Another 11 percent of 12b-1 fees fell in the reporting period ended October 1999.