

# Fundamentals

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## 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.<sup>1</sup> 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.

<sup>1</sup> See John D. Rea and Brian K. Reid, "Trends in the Ownership Cost of Equity Mutual Funds," *Perspective*, Investment Company Institute, Vol. 4, No. 3 (November 1998), pp. 11-12 for a discussion of this development for equity funds. The substitution of 12b-1 fees for front-end loads contributed significantly to the substantial reduction over the past two decades in the cost of purchasing bond and equity funds. See John D. Rea, Brian K. Reid, and Travis Lee, "Mutual Fund Costs, 1980-1998," *Perspective*, Investment Company Institute, Vol. 5, No. 4 (September 1999), pp. 1-2.

figure 1

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

	<b>Number</b>	<b>Assets (billions)</b>
All share classes with 12b-1 plans <sup>1</sup>	8,293	\$2,685
Share classes with 12b-1 plans among survey respondents <sup>2</sup>	4,285	1,854
Memo: Ratio of survey respondents to all share classes (percent)	52%	69%

<sup>1</sup> Investment Company Institute.

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

note: Variable annuities included.

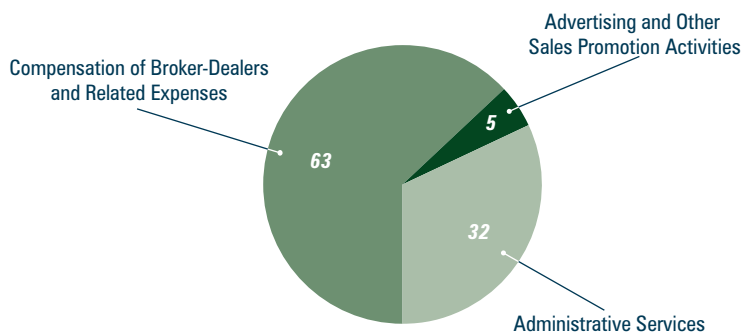
At the end of 1999, 242 of the ICI's 434 member complexes had at least one fund with a 12b-1 plan. Of the 242 members with 12b-1 plans, 95 members (39 percent) responded to the survey. Survey respondents accounted for 52 percent of all mutual fund share classes with 12b-1 plans and for 69 percent of assets in all share classes with 12b-1 plans (Figure 1).<sup>2</sup> 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).<sup>3</sup> 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.

figure 2

**Use of 12b-1 Fees, 1999**

(percent of total 12b-1 fees)



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

<sup>2</sup> At 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.

<sup>3</sup> Differences 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.