

A TOUCH OF CLASS: MUTUAL FUND SHARE CLASS DEVELOPMENTS (PART 1)

JEFFREY S. PURETZ is a partner in Dechert's Washington D.C. office.

JAMES V. CATANO, ERICA EVANS, SHAYNA GILMORE, and
CHRISTINE A. SCHLEPPEGRELL are Associates in Dechert's Washington, D.C. office.

MELISSA A. O'NEILL is an Associate in Dechert's Washington, D.C. office

INTRODUCTION AND BACKGROUND

Over the past two years, the mutual fund distribution and share class landscape has experienced considerable changes in light of several regulatory developments, notably the new and amended fiduciary "investment advice" regulations issued in April 2016 by the Department of Labor ("DOL") under the Employee Retirement Income Security Act of 1974 ("ERISA") and the Internal Revenue Code of 1986. Other regulatory pressures are also driving these changes, including the renewed examination and enforcement focus of the Securities and Exchange Commission ("SEC") and Financial Industry Regulatory Authority ("FINRA") on share class selections or recommendations made by financial advisers and broker-dealers and other sales-related matters (e.g., the application of sales charge waivers). In addition, interpretive guidance published by the Staff of the SEC regarding "clean shares" and other share class matters has contributed to the broad registration of new share classes and in some cases the repurposing of existing share classes, as well as other product initiatives and changes in the distribution structure for mutual fund shares. However, considerable uncertainty remains as fund groups grapple with how best to position themselves in this new and evolving landscape, particularly as future regulatory changes in this context are anticipated by many in the industry, including a potential standard of conduct proposal by the SEC, as well as the possible elimination of the DOL fiduciary rule and its exemptions.¹

This outline provides an overview of the legal and regulatory background of certain mutual fund share class considerations and summarizes recent regulatory

guidance and several disciplinary or enforcement proceedings relating to share class structures and sales and distribution arrangements for mutual funds. As the mutual fund industry continues to evaluate the ongoing impact of these developments on fund products and sales, it is important to be mindful of potential business, legal and regulatory implications, each of which presents distinct challenges.²

A. Overview of Rule 18f-3

Rule 18f-3 under the Investment Company Act of 1940 (the "1940 Act") provides a relatively flexible framework for a fund's issuance of multiple classes of shares representing interests in the same portfolio and is designed to, among other things, increase investor choice. The rule allows funds, without the need for an individual exemptive order, to tailor their product offerings in an effort to meet the needs of different distribution channels or shareholder preferences, as funds generally offer multiple classes of shares to provide investors a choice of share class features. Rule 18f-3 sets forth certain requirements for funds issuing multiple classes of shares that are intended to protect investors by addressing the inherent conflicts of offering multiple classes of shares of the same fund. In addition, the rule establishes specific oversight responsibilities for fund boards with respect to multiple class structures.

The SEC adopted Rule 18f-3 in February 1995 to permit open-end management investment companies to issue multiple classes of voting stock representing interests in the same fund.³ Prior to the SEC's adoption of the rule, funds seeking to issue multiple classes of shares were required to apply for exemptions from

Section 18(f)(1) and Section 18(i) under the 1940 Act, which in part prohibit the issuance of a senior security by registered open-end funds. Between 1985 and 1995, the SEC issued approximately 200 exemptive orders allowing funds to issue multiple classes of shares, typically with different distribution arrangements.⁴ These exemptive orders typically imposed as many as 20 conditions designed to address the SEC's various investor protection concerns associated with conflicts in offering multiple classes of shares of a fund.⁵

In adopting Rule 18f-3, the SEC sought to reduce the amount of time and expense for funds involved in offering multiple classes of shares and reduce the SEC's burden of reviewing exemptive applications while providing funds with the flexibility to tailor their products to meet investor demands and seek to access different investor markets. To continue its goal of preserving what the SEC considered key investor protection principles, the SEC codified many of the conditions contained in these exemptive orders and derived from the concerns underlying Section 18 of the 1940 Act within Rule 18f-3.

A fund offering multiple classes of shares pursuant to Rule 18f-3 must provide that each class have the same rights and obligations, except as follows:

- Expenses
 - Shareholder servicing or distribution: each class must have a different arrangement for shareholder services or the distribution of securities or both, and pay the expenses of that arrangement;⁶
 - Expense allocations: different classes may pay a different share of other expenses, not including advisory or custodial fees or other expenses related to the management of the company's assets, if these expenses are actually incurred in a different amount by that class, or if the class receives services of a different kind or a different degree than other classes;
 - Advisory fees: different classes may pay a different advisory fee to the extent that any difference in amount paid is the result of the application of the same performance fee provisions in the advisory contract of the company to the different investment performance of each class;

- Voting rights: each class must have exclusive voting rights on any matter submitted to shareholders that relates to the class's servicing or distribution arrangement or in which the interests of the classes differ; and
- Exchange privileges and conversions: separate classes may have different exchange privileges or conversion features (including automatic conversions) provided that the conversion is effected on the basis of the relative NAV of the two classes without the imposition of any sales charge, fee, or other charge, and the expenses, including fees pursuant to Rule 12b-1 under the 1940 Act, of the new class are not higher than the expenses of the old class.

Although Rule 18f-3(a)(1)(ii) generally prohibits different classes from paying a different share of advisory and custodial fees, Rule 18f-3(b) provides that expenses may be waived or reimbursed by the fund's adviser, underwriter, or any other provider of services to the fund.⁷ Rule 18f-3(c) provides for certain permissible methods for the allocation of income, realized gains and losses, unrealized appreciation and depreciation and fund-wide expenses to each class.

Rule 18f-3(d) requires that any payments shall be made pursuant to a written plan that delineates the separate arrangement and expense allocation of each class, and any related conversion features or exchange privileges. Such a plan (a "Rule 18f-3 plan") and any material amendments to the plan must be approved by a majority of the directors and a majority of those directors who are not "interested persons" of the fund, as such term is defined in Section 2(a)(19) of the 1940 Act ("Independent Directors"), based on a finding that the Rule 18f-3 plan, including the expense allocation, is in the best interests of each class individually and the company as a whole.

B. Overview of Section 22(d) and Rule 22d-1

Section 22(d) of the 1940 Act prohibits a fund, its principal underwriter or any dealer from selling fund shares except at a current public offering price (i.e., NAV plus a sales charge) described in the fund's prospectus. Section 22(d) has historically been interpreted as allowing a fund, not the dealer, to fix the sales charge price on fund shares, thereby prohibiting price competition in sales charges among dealers in fund shares. Section 22(d) applies to "dealers," but by its terms does not

apply to “brokers” (each of which is defined in the 1940 Act by reference to the definition for each term found in the Securities Exchange Act of 1934).

Rule 22d-1 provides a limited exemption from the prohibitions under Section 22(d) by permitting variations in, or the waiver of, initial sales charges, provided that variations or waivers are applied uniformly to “particular classes of investors or transactions” and are adequately disclosed in accordance with requirements relating to fund registration statements, as described below.⁸ Rule 22d-1 was designed to allow funds to set prices for their share classes, and historically the SEC Staff has interpreted and applied Rule 22d-1 flexibly to allow funds to offer investors lower sales charges or other benefits or in otherwise structuring the manner in which shares are sold.⁹ In fact, the SEC’s view of Section 22(d) and Rule 22d-1 may be considered to be quite broad, as the SEC and the Staff have struggled to apply what many consider to be, in effect, an anti-competitive provision of the 1940 Act.¹⁰

The conditions under Rule 22d-1 are as follows:

- i. The company, the principal underwriter and dealers in the company’s shares must apply any scheduled variation uniformly to all offerees in the particular class of investors or transactions specified;
- ii. The company must furnish to existing shareholders and prospective investors adequate information concerning any scheduled variation, as prescribed in applicable registration statement form requirements (i.e., Item 12(a)(2) of Form N-1A);
- iii. Before making any new sales charge variation available to purchasers of the company’s shares, the company must revise its prospectus and statement of additional information to describe that new variation; and
- iv. The company must advise existing shareholders of any new sales charge variation within one year of the date when that variation is first made available to purchasers of the company’s shares.¹¹

Currently, Rule 22d-1 requires registration statement disclosure regarding variations in or waivers of sales charges and does not expressly permit negotiated

sales charges.¹² As originally proposed in 1983, Rule 22d-6 would have permitted negotiated sales charges with a maximum sales charge typically established by a fund, subject to certain conditions.¹³ Although the final rule amendments did not permit such negotiation, this concept re-emerged in a SEC Staff report published in 1992 and in a 2010 release proposing Rule 12b-2 and amendments to other rules (not subsequently adopted). In the 1992 report, the SEC Staff recommended that Congress amend Section 22(d) to end retail price maintenance and permit the development of price competition among dealers, as well as to promote a secondary market in mutual fund shares, finding that compelling reasons no longer existed to retain retail price maintenance.¹⁴ In connection with proposing Rule 12b-2, the SEC proposed to amend Rule 6c-10 to give funds the option of offering shares that could be sold with sales charges established at the intermediary level.¹⁵ The SEC anticipated that this elective sales charge and distribution model would, among other things, promote greater price competition and possibly lower costs for investors.¹⁶ The SEC viewed this proposal as potentially simplifying the operations of dealers, permitting dealers to process transactions pursuant to a single, uniform fee structure rather than by complying with myriad distribution arrangements—this could help avoid mistakes that harm customers and avoid exposing dealers to liability for errors in processing these charges.¹⁷

C. Overview of Section 12(b) and Rule 12b-1

Section 12(b) of the 1940 Act prohibits a fund from acting as a distributor of its own shares (except through an underwriter), in contravention of SEC rules. In October 1980, the SEC adopted Rule 12b-1, giving effect to this prohibition and making it unlawful for any fund to directly or indirectly finance “any activity which is primarily intended to result in the sale of [fund] shares,” other than pursuant to a written plan of distribution meeting the requirements of Rule 12b-1 (a “12b-1 Plan”).¹⁸

Rule 12b-1 sets out specific substantive and procedural conditions for the payment of 12b-1 fees pursuant to a 12b-1 Plan, including that the 12b-1 Plan (and any related agreements) must be approved by a vote of the majority of the directors of the fund and a majority of those directors who (a) are Independent Directors, and (b) have no direct or indirect financial interest in the operation of the 12b-1 Plan or in any agreements

related to the Plan (“Independent 12b-1 Directors”). Such approval must be cast in person at a meeting called for the purpose of voting on such 12b-1 Plan or agreements. In addition, in the event that the 12b-1 Plan is adopted after any public offering of the voting securities of the fund or after any sale to any person not affiliated with the fund or promoter (generally, the investment adviser of the fund or the principal underwriter of the shares of the fund), or affiliated persons of such person, such 12b-1 Plan must be approved by a vote of at least a “majority of the outstanding voting securities of the fund” (“Majority Shareholder Vote”).¹⁹

The 12b-1 Plan must describe all material aspects of the proposed financing or distribution and provide, in substance:

- That it shall continue in effect for a period of more than one year from the date of its execution or adoption only so long as such continuance is specifically approved at least annually by a majority of the directors and a majority of the Independent 12b-1 Directors, at the in-person meeting called for the purpose of voting on it;
- That any person authorized to direct the disposition of moneys paid or payable by the fund pursuant to the 12b-1 Plan or agreement will provide to the fund board of directors, who will review, at least quarterly, a written report of the amounts so expended and the purposes for which such expenditures were made;
- In the case of the 12b-1 Plan, that it may be terminated at any time by a vote of a majority of the Independent 12b-1 Directors, or by a Majority Shareholder Vote; and
- In the case of a related agreement, (i) that it may be terminated at any time, without the payment of any penalty, by a vote of the Independent 12b-1 Directors or by a Majority Shareholder Vote on not more than sixty days written notice, and (ii) for its automatic termination in the event of its “assignment” (as defined under the 1940 Act).

The 12b-1 Plan must provide that it may not be amended to increase materially the amount to be spent for distribution without shareholder approval and that all material amendments be approved by a vote of a majority of the directors and by the vote of a majority of the Independent 12b-1 Directors, cast in

person at a meeting called for the purpose of such vote.

Rule 12b-1 has remained largely unchanged since its adoption over 30 years ago, and although the SEC has undertaken several rulemaking initiatives related to Rule 12b-1, it has only adopted a limited number of amendments that do not impact the scope of Rule 12b-1 as it relates to fund payments to intermediaries.²⁰ On multiple occasions, the SEC Division of Investment Management Staff has responded to requests for no-action assurance and provided guidance with respect to particular arrangements.²¹

D. FINRA Rule 2341

FINRA Rule 2341 (“Rule 2341”), which applies to all FINRA member firms, extends FINRA’s regulation of fund sales charges to asset-based sales charges, including distribution fees charged under plans adopted pursuant to Rule 12b-1.²² Rule 2341 is intended to ensure that most fund shareholders generally pay no more for sales and distribution expenses through an asset-based fee than through a front-end sales charge.

FINRA Rule 2341: (i) places a cap on the total sales charges—asset-based, front-end and deferred—that may be levied by a fund;²³ (ii) limits the maximum amount of an annual asset-based sales charge to 0.75 percent for a mutual fund sold by FINRA members; and (iii) allows a 0.25 percent annual service fee to be paid by a fund for certain “shareholder liaison” services,²⁴ which will not be considered a sales charge.

II. THE EVOLUTION OF SHARE CLASSES

Before funds were permitted to offer multiple share classes, almost all mutual funds were sold to investors through intermediaries, usually a broker-dealer, and the intermediaries were compensated by the shareholders through a front-end sales charge, discussed below. In the 1960s, front-end sales charges were often as high as 8.5 percent of the investment amount (i.e., NAV plus 8.5 percent).²⁵ Front-end sales charges have generally decreased over time, but, as discussed below, certain share classes still impose front-end sales charges. In addition, before mutual funds were permitted to offer multiple share classes, fund structures were less efficient. For example, as discussed in the adopting release for Rule 18f-3, multiple share classes offered in a single fund avoid the need for fund complexes to create “clone” funds.²⁶ A “clone” fund is a duplicative

fund that essentially achieves the concept of offering a separate share class, but that is less efficient because it is separately registered and therefore incurs additional, duplicative management and administrative expenses.²⁷

The first significant change to this distribution model came with the introduction of money market funds in the early 1970s, which were sold directly by the mutual fund management companies to the public frequently without using or compensating intermediaries.²⁸ Money market funds were also sold without a front-end sales charge. This led some mutual fund management companies to offer all of their funds, not just money market funds, in this way, directly to the public. Without the involvement of an intermediary, the funds were sold without a sales charge, and these no-load funds were attractive to investors who did not want to pay for the services of a broker-dealer.²⁹

Once funds were permitted to charge Rule 12b-1 fees and offer multiple share classes, the share class offerings evolved significantly for investors purchasing shares through an intermediary. The three standard share classes historically offered to individual investors through an intermediary were Class A, B and C shares, although there are variations in these historical share classes. The next section provides an overview of the common fee structures for each of these share classes. The section then discusses the more recent transition to investing platforms, such as fund supermarkets and wrap fee programs, and touches on the introduction and growth of retirement plans and the evolution of share classes for investment through retirement plans. Finally, this section discusses recent regulatory developments related to sub-accounting fees.

A. Class A, B, and C Shares

Class A, B, and C shares are the three share classes that historically are most standardized industry-wide, although many fund complexes have been in the process of phasing out Class B shares in recent years through conversions into other available share classes. These share classes typically differ based on the type and size of the sales charges as well as the Rule 12b-1 fee rate that shareholders pay. Class A, B, and C shares are traditionally sold to shareholders through an intermediary, and, for these share classes, there are three primary fee types by which the intermediary may be

paid for providing distribution and other services to shareholders.

Front-end sales charges. A front-end sales charge, or front-end charge, is based on a fixed percentage and is paid by the investor immediately upon purchasing the shares (i.e., it reduces the amount of the purchase that ultimately is invested in a fund). The amount of a sales charge varies depending on the fund complex, but as of 2013, the maximum sales charge on stock funds averaged 5.3 percent.³⁰ Many fund complexes, however, may choose to waive sales charges or offer discounts based on the type of investor or the size of an investor's purchase. For example, many fund complexes have breakpoint pricing on sales charges, which is permitted under Rule 22d-1, as described above. Under this type of pricing scheme, the sales charge percentage decreases as the amount of the investment reaches certain set "breakpoints."

Back-end sales charges and contingent deferred sales charges. A back-end charge, or contingent deferred sales charge ("CDSC"), is paid when a shareholder redeems fund shares, rather than at the time of purchase. Such fees typically are only imposed if a shareholder redeems the shares after holding the shares for less than a specified period of time. In addition, the percentage rate of such fees may decline as the investor approaches the minimum holding period. Share classes with a CDSC typically also charge shareholders a Rule 12b-1 fee. For a share class that imposes a CDSC, the fund distributor generally advances the intermediary a fee at the time of purchase. As the investor holds the shares, a portion of the Rule 12b-1 fee collected by the fund is typically paid to the intermediary by the fund distributor, and a portion is kept by the fund distributor as reimbursement for the upfront payment it made to the intermediary at the time of purchase. If the shareholder redeems the shares before the Rule 12b-1 fee can fully reimburse the fund distributor, the CDSC is intended to reimburse the distributor for the remainder of the upfront payment to the intermediary.

Rule 12b-1 fees. As discussed above, Rule 12b-1 fees are fees that are charged to shareholders on an ongoing basis to support fund distribution costs. Fees paid under a 12b-1 Plan may also be used to cover servicing (non-distribution) costs, although these services may be paid by a fund inside or outside of a 12b-1 Plan.³¹ As discussed in Section I.C above, Rule 12b-1 fees must be approved by the fund's board of directors on an annual

basis and are limited to one percent of the investor's assets invested in the fund. The fund distributor may keep a portion of the Rule 12b-1 fee collected or share all or a portion with the intermediary.

1. Class A Shares

Class A shares are traditional front-end charge shares typically offered to individual investors through intermediaries. Class A shares generally have a higher front-end sales charge than other share classes, although the sales charge may be reduced through breakpoints or waivers and may vary by asset class or other fund characteristic. Class A shares often also charge a Rule 12b-1 fee and/or shareholder servicing fee at an annual rate of 0.25%. Class A shares remain popular, particularly for investors who may qualify for a reduced or waived sales charge or who intend to hold the shares for a long period of time.³² Class A shares may be more attractive to long-term investors than certain other classes, because, over a longer period of time, the annual Rule 12b-1 fees charged on other available share classes may eventually, in the aggregate, become more costly than the front-end sales charge (and any Rule 12b-1 fee) the investor would pay on Class A shares, if applicable to the investor. Rule 12b-1 fees are paid from fund (and class) assets on an ongoing basis and will increase the cost of an investment over time. In contrast, a front-end sales charge is a one-time fee paid on the investor's initial investment (which reduces the amount of the investment in the fund).

2. Class B Shares

Shortly after the adoption of Rule 12b-1, the SEC first granted an exemption to allow a fund group to charge a CDSC coupled with a Rule 12b-1 fee at an annual rate of 1.00%, thereby allowing a structure that ultimately came to be known as Class B shares.³³ Class B shares generally do not impose a front-end sales charge, and instead often charge investors a 12b-1 fee, which may include shareholder servicing fee, of 1.00%, as well as a CDSC. In addition, most fund complexes have built an automatic conversion feature into their Class B shares such that after a certain number of years, such as seven or eight years, Class B shares are automatically converted to Class A shares or another share class. The period of time before conversion is intended to roughly estimate the period of time needed to fully reimburse the fund distributor for the sales commission paid to the intermediary at the time of sale.³⁴

Class B shares were popular for investors in the 1990s as a result of not imposing front-end sales charges, but they have fallen out of favor as the SEC and FINRA focused on regulatory concerns related to the Class B fee structure as early as 2004. Several SEC enforcement actions related to the offering of Class B shares are summarized in Section IV.A.1 below. Generally, regulators were concerned that certain shareholders were being improperly sold Class B shares when they would have qualified for sales charge discounts on Class A shares, and were therefore paying for a higher cost share class than was necessary.³⁵ As a result, intermediaries largely stopped selling Class B shares and many fund complexes stopped offering Class B shares for sale.³⁶

3. Class C Shares

Class C shares generally have a higher Rule 12b-1 fee than Class A shares and a smaller CDSC than Class B shares, with no front-end charge. The fund distributor generally pays an annual sales commission to the intermediary for the duration of time that a shareholder's investment persists in Class C shares. The amount paid in the first year of an investment is invariably lower than the sales commission advanced for Class B shares at the time of investment, but the commissions persist for longer. An intermediary is generally paid an annual commission equal to all or most of the annual Rule 12b-1 fee paid by the class.³⁷ Class C shares are sometimes referred to as "level load" shares.

4. Other Share Classes

In addition to Class A, B, and C shares, there are a number of classes offered by fund families that are intended to meet the needs and preferences of specific distribution channels, such as Institutional Class shares or Retirement Class shares. Institutional Class shares and Retirement Class shares, for example, generally limit the share class eligibility to large investors (or investors meeting relatively high minimum initial investment amounts) or retirement plans. These classes typically do not impose a sales charge or involve a Rule 12b-1 fee but may do so, for example, to meet the preferences of certain distribution channels.

B. Transition to Investing Platforms

In the early 1990s, the intermediary channel for mutual fund distribution began to evolve and transition toward new types of investing platforms—largely driven by the development of new platforms and products by

intermediaries to attract investors to purchase fund shares through their platforms. The fee structures of investing platforms differ by the type of platform and the intermediary offering the platform, but this section generally discusses two common platform types and mutual fund investing through retirement plans. Ultimately, these platforms offer investors the ability to purchase funds across fund families through one medium that provides a variety of practical servicing functions for shareholders, resulting in increased convenience and efficiencies for fund investors.

The growth of investing platforms has also substantially increased the prevalence of omnibus accounts and sub-accounting service arrangements. This shift has been acknowledged by the SEC, which noted that intermediaries, through such investing platforms, have “assumed many of the recordkeeping and ongoing servicing and support functions for shareholders that funds otherwise would perform.”³⁸ An omnibus account is a master account that represents sub-accounts of multiple investors. In an omnibus account model, the intermediary has an omnibus account with a mutual fund, which represents the investments of many individual investors in that particular fund. The mutual fund typically does not have information about individual investors, and the intermediary instead aggregates transactions and performs typical recordkeeping and account services, such as maintaining financial records and account information of shareholders, disbursing dividends and distributing capital gains, mailing trade confirmations, shareholder reports and prospectus updates, and tax reporting.³⁹ Historically, many of these services were performed by fund transfer agents.⁴⁰ This shift and the increase of the payment of sub-accounting fees to intermediaries have prompted the SEC to focus on these types of services and payments, as discussed in Section II.D below.

1. Fund Supermarkets

The first fund supermarket was launched in 1992 and quickly grew in popularity.⁴¹ Supermarkets allow investors to access funds across multiple fund complexes from a single account relatively inexpensively. Instead of the investors paying sales charges (if any), the intermediary is compensated for allowing the fund to participate in the supermarket and for providing certain services to the fund, including administrative and distribution services, onboarding-type activities and other services.⁴² Investors often open accounts and

enter into transactions themselves through web-based interactive tools or client portals, which is convenient for investors and helps maintain lower transaction and other account-level costs for customers. The share classes offered through supermarkets are traditionally no-load share classes.⁴³

In 1998, the SEC Division of Investment Management issued a letter to the Investment Company Institute that provided guidance with respect to certain legal issues it believed arose in connection with fund payments to intermediaries in the context of fund supermarkets (“Supermarkets Letter”).⁴⁴ In this letter, the SEC Staff acknowledged the increasing prevalence of fund supermarkets. The Supermarkets Letter discussed examinations by the SEC Office of Compliance Inspections and Examinations (“OCIE”) of fund supermarkets and related findings, noting that, “[i]n particular, OCIE sought to determine whether funds that treated some or all of the fund supermarket fee as payment for non-distribution services were financing the distribution of their shares outside of a rule 12b-1 plan, in violation of rule 12b-1 under the [1940 Act].”⁴⁵ In its examinations, OCIE found that some funds characterized all of the services they received as distribution-related and paid for them through 12b-1 fees, but that other funds characterized a portion of the fee as administrative and therefore paid for it outside of a 12b-1 Plan. The Supermarkets Letter provided that, “[w]hen a fund participates in a fund supermarket primarily to sell its shares to investors, at least part of the fee must be considered to be compensation paid to the sponsor for providing distribution services,” and, therefore, that portion of the fee should be paid pursuant to a 12b-1 Plan.⁴⁶ Conversely, the SEC Staff indicated that “[i]f a fund has not adopted a rule 12b-1 plan, then it cannot use fund assets to pay for services that are primarily intended to result in the sale of fund shares.”⁴⁷ The fund’s board of directors is therefore responsible for deciding the factual question of whether a portion of the fee paid by the fund to the intermediary is primarily intended to result in the sale of fund shares.⁴⁸ The Supermarkets Letter lists factors that the board of directors should consider, including:

“the nature of the services provided; whether the services provide any distribution benefits; whether the services provide non-distribution related benefits and are typically provided by fund service providers; the costs that the fund could reasonably be expected to incur for comparable services

if provided by another party, relative to the total amount of the supermarket fee; and the characterization of the services by the fund supermarket sponsor.⁴⁹

The Supermarkets Letter also provides that a fund's board of directors should consider payments made by the fund's adviser, and that the board should periodically review its determinations for consistency with Rule 12b-1.⁵⁰ Specifically, the SEC Staff stated that "the directors of the fund . . . must satisfy themselves either that the management fee is not a conduit for the indirect use of the fund's assets for distribution, or that the fund has complied with rule 12b-1."⁵¹ The SEC Staff's concerns that payments made outside of a 12b-1 Plan are in fact being used to pay for activities that are primarily intended to result in the sale of fund shares (i.e., distribution-related activities, as the context requires) were also recently raised in connection with the SEC's distribution in guise enforcement sweep, as discussed in Section II.D below.

2. Wrap Programs

Wrap programs evolved out of fund supermarkets and have grown into a popular option for investors that are looking for convenient access to funds from multiple fund complexes and the benefits of choosing from a grouping of funds specifically selected by the intermediary for inclusion in the program.⁵² Investors generally pay a fee to participate in a wrap program, typically a fee based on a set percentage of the investor's assets in the programs paid on an annual basis. The intermediary through which the program is offered chooses funds to be offered through the program. These are generally funds that the intermediary believes meet certain investment strategy or other criteria, such as providing participants in the program a diverse set of funds to choose from that represent a variety of asset types, objectives, and strategies, and have established track records.

Regulators and government officials have at times expressed concern over wrap fee programs. In 1992, Representative John Dingell, Chairman of the Committee on Energy and Commerce, wrote a letter to Chairman of the SEC, Richard Breeden, stating that the Committee was "examining the growth of wrap-fee accounts at U.S. securities firms" as "[c]oncerns ha[d] been raised about, among other things, the amount and structure of the fees associated with these

products."⁵³ In a second letter, Dingell elaborated that industry experts had advised that these programs raised certain regulatory questions, listing concerns including, among others, "whether the total fee is in line with the aggregate of fees otherwise payable for individual component services; whether the wrap fee involves a disguised referral fee or 'kickback' arrangements; . . . what standards should be applicable to selection of executing brokers and determining best execution; . . . and whether the disclosure to clients is adequate."⁵⁴ In his response letters, Chairman Breeden indicated that wrap fee programs raised issues of suitability as well as best execution and noted that the Divisions of Investment Management and Market Regulation had been studying the structure of wrap fee programs and monitoring intermediaries and investment advisers participating in the programs.⁵⁵

More recently, in 2014 OCIE included wrap fee programs in its Examination Priorities, stating "[t]he staff will assess whether advisers are fulfilling their fiduciary and contractual obligations to clients and will review the processes in place for monitoring wrap fee programs recommended to advisory clients, related conflicts of interest, best execution, trading away from the sponsor, and disclosures."⁵⁶ Later that year, the SEC prevailed in a fraud case against an adviser who, among other things, placed his clients into wrap programs in a fashion the SEC thought was improper.⁵⁷ The SEC's complaint alleged that the defendant had made false and misleading statements about the wrap fee and about the services he was going to perform for the fee.⁵⁸ The complaint also alleged that, although the adviser's public filings claimed he was providing various advisory services for the accounts, the adviser "did little more than sit back and wait for the clients' wrap fee payments to roll in."⁵⁹

3. Retirement Plans

The growth of 401(k) and Individual Retirement Account ("IRA") plans has amplified the importance of the retirement distribution channel for funds. As of the end of 2013, retirement plan assets made up over one-third of all mutual fund industry assets, and conversely, 60 percent of assets in 401(k) plans were invested in mutual funds.⁶⁰ The growth of these plans has led to funds offering additional share classes specifically to retirement plans, such as Class R shares and variations on this share class. Class R shares are generally sold without a front- or back-end sales charge and

may include Rule 12b-1 fees or fees for shareholder servicing-like activities.⁶¹ In addition, although share class eligibility varies, retirement plans often may also purchase no-load classes, such as Class I shares, which generally do not charge Rule 12b-1 fees, but which often have a relatively high minimum initial investment requirement.

C. Regulatory Developments Related to “Distribution in Guise”

1. Sub-Accounting Fees

Sub-accounting fees, also known as sub-transfer agent fees or sub-TA fees, may be paid by a fund to an intermediary for shareholder administration, recordkeeping, or other similar services for omnibus accounts and are characterized as non-distribution related fees. These servicing structures are often between funds or their service providers and intermediaries and have become more common in light of the growth of omnibus arrangements.⁶² Although the SEC has not precisely defined services that are considered to be “non-distribution” in nature,⁶³ the SEC has stated that examples include,

communicating with [fund] shareholders about their fund holdings; maintaining [investors'] financial records; processing changes in customer accounts and trade orders; recordkeeping for customers; answering customer inquiries regarding account status and the procedures for the purchase and redemption of fund shares; providing account balances and providing account statements, tax documents, and confirmations of transactions in a customer's account; transmitting proxy statements, annual reports and other communications from a fund; and receiving, tabulating and transmitting proxies executed by customers.⁶⁴

Fund payments for non-distribution services are permitted under the 1940 Act and need not be paid under a 12b-1 Plan, even if the intermediary is also involved in the distribution of fund shares.⁶⁵ However, the payment of sub-accounting fees could implicate Section 12(b) and Rule 12b-1 if the payments are made outside of a Rule 12b-1 Plan and used to compensate an intermediary for any activity that is primarily intended to result in the sale of fund shares. In early 2013, OCIE identified the payment of sub-accounting fees as an examination priority and conducted sweep exams of

funds, investment advisers, broker-dealers and transfer agents, specifically reviewing payments made to intermediaries that distribute or promote fund shares. OCIE again identified this issue as an examination priority for 2014, and in February 2015, senior Staff of the Asset Management Unit of the SEC's Division of Enforcement announced that fund payments to intermediaries would be an enforcement priority in 2015. This area of SEC focus is referred to as “distribution in guise” because the SEC Staff was concerned that such sub-accounting payments were paying for distribution-related services outside of a 12b-1 Plan. This is an example, as with fund supermarkets, of when the SEC was concerned with and focused on possible payments for distribution-related services outside of a 12b-1 Plan.

2. First Eagle Investment Management Enforcement Action

As a result of the distribution-in-guise sweep, the SEC brought and, in September 2015, settled an enforcement action against First Eagle Investment Management, LLC (“First Eagle”).⁶⁶ The SEC found that First Eagle had caused the mutual funds that it advised (“First Eagle Funds”) to make payments to two intermediaries that were characterized by First Eagle as sub-accounting payments but that were paid pursuant to agreements under which the services related to distribution and marketing. The SEC found that over a six-year period, approximately \$25 million in the First Eagle Funds' assets were paid for distribution services outside of a 12b-1 Plan. In addition, the SEC order said that the First Eagle Funds' registration statement disclosure concerning these payments and services was inaccurate. As a result, the SEC found that First Eagle had violated Section 12(b) and Rule 12b-1, as well as Section 34(b) of the 1940 Act (related to the inaccurate registration statement disclosures) and Section 206(2) of the Investment Advisers Act of 1940 (“Advisers Act”) (which makes it unlawful for any investment adviser to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client).

3. William Blair and Calvert Enforcement Actions

On May 1, 2017 and May 2, 2017, the SEC settled a pair of enforcement actions related to Rule 12b-1 against, respectively, William Blair & Company, L.L.C. (“William Blair”), a registered investment adviser and broker-dealer, and Calvert Investment Distributors, Inc.,

a registered broker-dealer, and Calvert Investment Management, Inc., a registered investment adviser (collectively, "Calvert").⁶⁷ The William Blair and Calvert enforcement actions involved similar circumstances, as discussed below.

The enforcement actions against William Blair and Calvert each involved violations of Section 12(b), and Rule 12b-1 thereunder, relating to fund payments for distribution outside of a Rule 12b-1 Plan and violations of Section 34(b) of the 1940 Act and Section 206(2) of the Advisers Act for inaccurate fund disclosures and inaccurate and incomplete board reporting. Fund trustees were not named parties in either case. Each of these actions involved self-identified and self-reported violations.

In William Blair, the SEC found violations of Section 12(b), and Rule 12b-1 thereunder, because William Blair "inadvertently misclassified" certain agreements and payments for distribution and marketing services as being for sub-transfer agency services paid by the funds.⁶⁸ As a result, William Blair had caused the funds to pay for distribution and marketing services outside of a Rule 12b-1 Plan, which were in addition to payments made to particular intermediaries under the Rule 12b-1 Plan. The SEC also determined that William Blair caused the funds to pay for sub-transfer agency services in excess of board approved limits because William Blair later learned that the fees calculated for certain intermediaries were based on the same underlying assets (i.e., the funds double paid). As a result, the SEC found that William Blair violated Section 34(b) of the 1940 Act and Section 206(2) of the Advisers Act for inaccurately disclosing fund limits relating to sub-transfer agency fees and providing inaccurate or incomplete reports to the funds' board relating to these payments. In settling this action, the SEC acknowledged "remedial acts promptly undertaken by William Blair." Specifically, the SEC stated that "[a]t the same time [OCIE notified William Blair that it planned an examination in this context], William Blair undertook an independent internal review of its intermediary arrangements and discovered the payments" cited in the action.⁶⁹ The SEC also acknowledged that "[a]fter identifying the payment errors, William Blair promptly notified the Board, reimbursed the Funds with interest, and supplemented its practices of providing oversight of payments to financial intermediaries."⁷⁰

In Calvert, the SEC found violations of the same statutes and regulation for improperly using fund assets to pay for distribution and marketing activities outside of a Rule 12b-1 Plan and for paying sub-transfer agency expenses in excess of board approved limits. Specifically, the SEC found that Calvert treated agreements for distribution and marketing services as being for sub-transfer agency services. In settling this action, the SEC agreed to impose a "reduced penalty" that reflected Calvert's "self-reporting of the improper fee payments, significant cooperation, and prompt remediation."⁷¹ The SEC acknowledged Calvert's "in-depth review of intermediary agreements" and prompt reporting to the SEC staff as well as implementation of enhancements to relevant procedures and intention to reimburse affected shareholder accounts.⁷²

4. IM Guidance Update

As a result of OCIE's distribution-in-guise sweep examinations, the SEC Staff recognized that the increase in omnibus account and sub-accounting service arrangements had caused funds to more frequently enter into arrangements with intermediaries for the provision of certain services and the payment of sub-accounting fees. The sweep examinations brought into focus certain issues regarding mutual fund distribution and sub-accounting fees and highlighted the need for the SEC Staff to clarify and update its existing related guidance.

On January 6, 2016, the Staff of the SEC's Division of Investment Management published a Guidance Update related to mutual fund distribution and sub-accounting fees.⁷³ Among other things, the Guidance Update provides SEC Staff recommendations with respect to the oversight responsibilities of a fund's board of trustees in connection with the board's consideration of whether sub-accounting fees are for services primarily intended to result in the sale of fund shares. The Guidance Update sets forth the following key recommendations:

- "Regardless of whether a fund has, or is considering adopting, a 12b-1 plan, boards of trustees should have a process in place reasonably designed to evaluate whether a portion of sub-accounting fees is being used to pay directly or indirectly for distribution.
- As part of this process, advisers and other relevant service providers should furnish sufficient information to inform the board of trustees of the overall

picture of intermediary distribution and servicing arrangements for the fund, including how the level of sub-accounting fees may affect other payment flows (such as 12b-1 fees and revenue sharing) that are intended for distribution.

- Advisers and other relevant service providers should inform boards of trustees if certain activities or arrangements that are potentially distribution-related exist in connection with the payment of sub-accounting fees, and if they do, boards of trustees should evaluate the appropriateness and character of those payments with heightened attention.⁷⁴

III. INDUSTRY RESPONSE TO THE DEPARTMENT OF LABOR FIDUCIARY RULE AND OTHER REGULATORY DEVELOPMENTS

A. The Department of Labor Fiduciary Rule

On April 6, 2016, the DOL released the final version of its “investment advice” regulation (“Fiduciary Rule”) and accompanying prohibited transaction exemptions (“Exemptions”).⁷⁵ The Fiduciary Rule covers retirement plans subject to ERISA, as well as IRAs and other non-ERISA plans. Compliance with all of the provisions of the Fiduciary Rule and certain conditions of the Exemptions was required by June 9, 2017. On November 29, 2017, the DOL announced an 18-month delay for compliance with the other conditions of the Exemptions. On March 15, 2018, the U.S. Court of Appeals for the Fifth Circuit issued an opinion vacating the Fiduciary Rule and Exemptions.⁷⁶ The Fiduciary Rule has drastically changed the fiduciary rules governing retirement plans and many industry practices by which financial products, including mutual funds, are marketed and sold to investors.

1. Who is a Fiduciary?

The Fiduciary Rule significantly expands the scope of who is considered a fiduciary in connection with advice provided to retirement investors. The initial test for determining whether a non-discretionary investment adviser is considered a fiduciary under the Fiduciary Rule is whether the adviser has made a covered “recommendation.” Under the Fiduciary Rule, a recommendation is “a communication that, based on its content, context and presentation, would reasonably be viewed as a suggestion that the advice recipient

engage in or refrain from taking a particular course of action.”⁷⁷ A covered recommendation relates to:

- The advisability of acquiring, holding, disposing of or exchanging investment property;
- How to invest assets that are being rolled over, transferred or otherwise distributed from a plan or IRA;
- The management of investment assets through advisory accounts or otherwise (such as regarding investment policies or strategies, portfolio compensation, selection of an investment adviser/manager or selection of investment account arrangements, in contrast to strictly taking orders from brokerage accounts); or
- Rollovers, transfers or other distributions from a plan or IRA (including whether, in what amount, in what form, and to what destination such a rollover, transfer or distribution should be made).

If a covered recommendation has been made, the adviser will be considered a fiduciary if one of the following is present:

- The adviser acknowledges fiduciary status;
- There is a written or verbal agreement, arrangement or understanding that the advice is based on the particular investment needs of the advice recipient; or
- The advice is directed to specific recipients regarding the advisability of a particular investment or management decisions.

Notably, the DOL has said that a “meeting of the minds” is not necessary for fiduciary status to be triggered under the Fiduciary Rule. Instead, if a reasonable person would expect that, due to the nature of the relationship, the adviser would consider the particular needs of the recipient of the advice, or if the adviser may be reasonably understood to have held itself out as a fiduciary, then the adviser may be considered a fiduciary.⁷⁸

The Fiduciary Rule also specifically includes certain carve-outs from the definition of “recommendation,” noting that merely providing a platform of investment alternatives, investment education or marketing communications will not necessarily qualify as a recommendation.⁷⁹ However, a facts-and-circumstances

analysis is required where communications and activities do not fit perfectly into an exclusion. Furthermore, even if a particular scenario would involve a covered recommendation, the Fiduciary Rule includes several exceptions for counterparty transactions, swaps and security-based swap transactions, and employee communications.⁸⁰

2. The “Best Interest Contract” Exemption

The Best Interest Contract Exemption (“BIC Exemption”) attempts to allow some flexibility with respect to certain compensation structures that are common in sales of mutual funds to retail investors, such as commissions, sales charges, 12b-1 fees, sub-accounting and revenue sharing payments.⁸¹ Currently, only compliance with the Impartial Conduct Standards conditions of the BIC Exemption is required. Compliance with the remaining conditions has been delayed until July 1, 2019.⁸² Without the BIC Exemption, these types of common compensation structures would be prohibited for fiduciaries under the broader scope of the Fiduciary Rule.

To rely upon the BIC Exemption with respect to a transaction recommended for an IRA or other non-ERISA plan, the financial institution (*e.g.*, a bank, insurance company, registered investment adviser, or registered broker-dealer that employs or retains an adviser) must enter into a written contract with the retirement investor that includes an acknowledgement of fiduciary status, a statement of certain conduct standards, and warranties that the financial institution has complied with, and will comply with, the BIC Exemption and other required disclosures. The required conduct standards (“Impartial Conduct Standards”) generally require that an adviser provide advice that is in the best interest of the investor and that is made without regard to the financial or other interests of the adviser, financial institution or affiliated entity.

Under the Exemptions, the Impartial Conduct Standards and the required warranties may make it difficult for intermediaries to receive, and for intermediaries to pay the financial advisers they employ, compensation that differs depending on the advice provided and/or investment product recommended to clients, referred to as “differential compensation.”⁸³ In addition, receiving differential compensation could increase the potential liability of an intermediary at the individual and firm levels under the BIC Exemption.

3. The “BIC Lite” Exemption

The BIC Exemption includes more streamlined compliance requirements, often referred to as “BIC Lite,” for fiduciaries that receive a fee that is either based upon a fixed percentage of the assets held by the investor or that otherwise does not vary with the particular investment recommended, and that pays only such level fees to any financial adviser involved with the advisory services. As with the BIC Exemption, currently fiduciaries are only required to comply with the Impartial Conduct Standards to qualify for the BIC Lite exemption. Compliance with the remaining conditions has been delayed until July 1, 2019.⁸⁴ BIC Lite has fewer requirements than the BIC Exemption, including, for example, that BIC Lite does not require that the fiduciary enter into a written contract with the investor. BIC Lite is intended to encourage fiduciaries to receive and pay out level fees, rather than differential compensation.⁸⁵

4. Impact on Mutual Fund Distribution through Intermediaries

If implemented fully in their current form, the Exemptions are expected to significantly impact the distribution of mutual funds through intermediaries. Prior to the issuance of the Fiduciary Rule, intermediaries that provided recommendations regarding investment products to retail retirement investors were generally not considered fiduciaries under ERISA, and instead were subject only to a requirement that an investment be suitable for a particular client.⁸⁶ Now, because the scope of who is considered a fiduciary has expanded to include intermediaries that make such recommendations, these intermediaries would become subject to the ERISA fiduciary duties of prudence and loyalty and, absent an applicable exemption, limited in their ability to receive fees with respect to investment products they recommend, including distribution-related compensation (such as 12b-1 fees and sales charges) and sub-accounting fees.

The BIC Exemption would generally allow such intermediaries to receive distribution-related compensation from funds and fund sponsors whose products they recommend; however, the conditions of the BIC Exemption must be met, including the requirement that the intermediary comply with the Impartial Conduct Standards. Because this means that the intermediary must provide advice without regard to the financial or other interests of the intermediary, there is concern in the industry that such intermediaries that

receive different levels of compensation from different fund sponsors could be challenged (including by private class action lawsuits) for not acting in the best interests of investors. The requirements of BIC Lite are less onerous; however, under BIC Lite, an intermediary cannot offer proprietary funds or unaffiliated funds pursuant to which the intermediary receives 12b-1 fees or revenue-sharing payments.⁸⁷

As a result of these potential issues with current distribution models for mutual funds through intermediaries, there has been a demand for new share classes from funds that would attempt to alleviate the issues and potential for increased fiduciary liability that such intermediaries are facing. Two of these new types of share classes, Class T shares and “clean shares,” are discussed in depth below. In addition, intermediaries have pushed funds to adopt intermediary-developed sales charge waiver arrangements that are designed to mitigate the potential for misapplication of sales charges and the intermediaries’ exposure to regulatory sanctions and liability. The Fiduciary Rule and Exemptions are also expected to continue to significantly impact the sale of mutual fund shares through retirement plans, which may lead to similar use of new or existing share classes that have no distribution charges, including 12b-1 fees.⁸⁸

5. Impact on Mutual Fund Distribution through Platforms

Mutual fund distribution through platforms, such as supermarkets and wrap fee programs, will also likely be impacted by the Fiduciary Rule. As discussed above, investment platforms are generally compensated in one of two ways for their services: (i) the investor pays the supermarket sponsor a transaction fee; or (ii) the underlying funds, their managers and/or their distributors or other affiliates pay the sponsor a percentage of the fund’s assets held at the platform, which may or may not be a 12b-1 fee, depending on the determinations of the fund’s board of directors. Platform sponsors may communicate with investors through their websites, call centers and financial consultants, and these communications sometimes relate to the merits of individual funds. Under the Fiduciary Rule, there is the potential that these communications could qualify the sponsor as a fiduciary, so sponsors will either have to address these issues to avoid being labelled a fiduciary for purposes of the Fiduciary Rule or will have to accept the fiduciary compliance requirements and

potential liability. Platform sponsors may be able to avoid fiduciary status by relying on certain exclusions for general communications, investment education and asset allocation models.⁸⁹

6. Current Status of the DOL Fiduciary Rule

The Fiduciary Rule and the Impartial Conduct Standards became applicable on June 9, 2017. On November 29, 2017, the DOL announced an 18-month delay until July 1, 2019 for compliance with the other conditions of the Exemptions.⁹⁰ Through the delayed compliance period to July 1, 2019, the DOL will not pursue claims against fiduciaries working diligently and in good faith to comply with the Fiduciary Rule and the Impartial Conduct Standards.⁹¹ During the delayed compliance period, fiduciaries are not required to disclose their fiduciary status to retirement investors or notify those investors that the Impartial Conduct Standards apply.⁹² While the Exemptions are currently available, compliance with some of the more controversial conditions of the Exemptions is also not required during the delayed compliance period. The DOL indicated that it intends to propose and finalize changes, if any, to the Fiduciary Rule and/or Exemptions before July 1, 2019 and coordinate with other regulatory agencies regarding fiduciary standards. Additionally, SEC Chairman Jay Clayton stated in a June 2017 speech that the SEC has been reviewing this area for some time and requested public comment on issues related to the standard of conduct for investment advisers and broker-dealers.⁹³ He further stated, in testimony before the House of Representatives Committee on Financial Services in October 2017, that the SEC is working on a standard of conduct rule proposal.⁹⁴ Notably, on March 15, 2018, the U.S. Court of Appeals for the Fifth Circuit issued an opinion vacating the Fiduciary Rule and Exemptions.⁹⁵ The DOL has stated that it will not enforce the Fiduciary Rule or Exemptions;⁹⁶ however, the deadline for the DOL and Department of Justice to appeal the Fifth Circuit decision has not yet passed as of the time this article was prepared. If the DOL and the Department of Justice choose not to appeal or otherwise challenge the panel’s vacatur of the Fiduciary Rule and Exemptions, then the Fiduciary Rule and Exemptions will be null and void nationwide.

Additionally, while the SEC is working on a standard of conduct rule proposal, several states have decided not to wait for the SEC’s action and have enacted or had introduced to the state legislature their own laws

and regulations relating to the standard of conduct for broker-dealers and investment advisers. These states include Connecticut, Nevada, New Jersey, and New York, with some of the laws still pending and other states working on their own similar legislation. However, these state laws exist in a gray area of federal preemption.⁹⁷

B. Class T Shares

One response to the Fiduciary Rule was the development of Class T shares in late 2016 and early 2017. Class T shares were designed to harmonize class features and establish a uniform compensation structure for intermediaries irrespective of fund or fund family. The goal was to remove the conflict of interest, and Fiduciary Rule concern, that arises when an intermediary receives higher compensation for selling a certain fund than it does for selling another fund. Eliminating compensation differences was one way to reduce conflicts of interest and incentivize intermediaries to recommend funds that are in the investor's best interest and avoid other conflicts that may arise from different share class structures among fund families. Typically, Class T shares would charge a 2.50 percent front-end sales charge with breakpoints at certain levels and a 0.25 percent Rule 12b-1 fee.⁹⁸ Many fund complexes have preliminarily filed to register or have registered Class T shares, but, as of the date of this article, most (if not all of these complexes) are not offering their Class T shares for sale as they await further clarity with respect to the implementation of the remaining parts of the Exemptions and other possible regulatory changes and, in turn, the resulting product needs or preferences of key distribution partners.

C. Clean Shares

A possible alternative product solution to Class T shares is "clean shares," which are characterized by the SEC staff as a share class that has no front-end sales charge, CDSC or asset based fee for sales or distribution ("Clean Shares").⁹⁹ Intermediaries acting as brokers would be permitted to set their own commissions for selling Clean Shares, which would be paid by the customer. Some fund complexes already offer share classes that appear to qualify as "clean shares." These complexes may choose to offer one of those existing share classes as Clean Shares in accordance with an interpretive letter provided to Capital Group in January 2017 ("Capital Group Letter") by simply (i) amending selling

agreements and (ii) adjusting their registration statement disclosure as needed to note that investors may pay additional fees to their intermediaries for transacting in these shares and that such fees are not reflected in the registration statement, to the extent necessary, to comply with applicable SEC Staff guidance.

The SEC Staff provided interpretive guidance clarifying certain regulatory considerations relating to the imposition of brokerage commissions or other charges on transactions in Clean Shares in the Capital Group Letter.¹⁰⁰ Capital Group requested interpretive guidance on this subject to address the question of whether an intermediary setting a commission that is not established by the fund would violate Section 22(d) and Rule 22d-1, which, as discussed in Section I.B, are generally intended to permit funds, not intermediaries, to set fund pricing. Capital Group requested that the SEC Staff clarify the conditions under which they would become subject to Section 22(d) and Rule 22d-1. The SEC Staff's response advised that Section 22(d), and thus Rule 22d-1, does not apply in circumstances where intermediaries are acting as "brokers" (i.e., "when engaged in the business of effecting transactions in securities for the account of others").¹⁰¹ Therefore, when transacting in Clean Shares on behalf of clients in such capacity, the SEC Staff's response indicated that the intermediaries could establish separate sales commissions.¹⁰²

In addition, in its response, the SEC Staff set forth five conditions for imposing brokerage commissions on the sale of Clean Shares:

- The broker will represent in its selling agreement with the fund's underwriter that it is acting solely on an agency basis for the sale of Clean Shares;
- The Clean Shares sold by the broker will not include any form of distribution-related payment to the broker;¹⁰³
- The fund's prospectus will disclose¹⁰⁴ that an investor transacting in Clean Shares may be required to pay a commission to a broker and, if applicable, that shares of the fund are available in other share classes that have different fees and expenses;
- The nature and amount of the commissions and the times at which they would be collected would be determined by the broker consistent with the broker's obligations under applicable law,

including but not limited to applicable FINRA and DOL rules; and

- Purchases and redemptions of Clean Shares will be made at NAV established by the fund (before imposition of a commission).¹⁰⁵

Some intermediaries and, in turn, a number of mutual fund complexes, have expressed an interest in the development of new share classes that (or adjustments to existing classes to) qualify as or resemble Clean Shares for sale in a variety of account and distribution structures. Currently, it is unclear when and if distribution structures for Clean Shares as contemplated in the Capital Group Letter will gain significant traction as a desirable solution for financial advisers and others involved in the sale of fund shares—although an intermediary has publicized it is currently offering Clean Shares for sale in this type of structure.¹⁰⁶ Other distribution structures for Clean Shares may also be viable. In addition, the precise contours and certain characteristics of Clean Shares for purposes of the Capital Group Letter remain subject to some uncertainty, particularly in light of the March 2018 decision of the U.S. Court of Appeals for the Fifth Circuit (as summarized above) and the potential for other regulatory developments.¹⁰⁷ Notwithstanding this uncertainty, some fund complexes, including complexes that offer share classes that would qualify as Clean Shares, have recently added to or refined their existing share class

lineup by registering a new class of shares or repurposing an existing class of shares to qualify as or otherwise have characteristics similar to Clean Shares.

D. Intermediary-Specific Sales Charges

In addition to (or instead of) offering a new share class in response to the Fiduciary Rule, a fund complex may disclose in its registration statement(s) intermediary-specific sales charge variations. The purpose of these firm-specific variations is to allow an intermediary to sell shares of funds across different fund complexes with the same sales charge structures, therefore reducing conflict of interest concerns relating to unequal compensation and to support easier operations processes for intermediaries. The SEC Staff addressed these intermediary-specific sales charge schedules in the 2016 IM Guidance Update, stating that if a fund takes this approach, its prospectus “disclosure should specifically identify each [i]ntermediary whose investors receive a sales load variation” and “must be presented in a clear, concise, and understandable manner, and should include tables, schedules, and charts where doing so would facilitate understanding.”¹⁰⁸ The movement toward intermediary-specific sales charges has been primarily driven by the intermediaries, rather than the funds, who are calling for these uniform sales charges to address operational and risk considerations related to the Fiduciary Rule. 🍷

Notes

- 1 See, e.g., Public Comments from Retail Investors and Other Interested Parties on Standards of Conduct for Investment Advisers and Broker-Dealers, SEC Chairman Jay Clayton (June 1, 2017), available at <https://www.sec.gov/news/public-statement/statement-chairman-clayton-2017-05-31>; *U.S. Chamber of Commerce v. DOL*, No. 17-10238, 2018 WL 1325019 (5th Cir. Mar. 15, 2018).
- 2 This outline is not intended to provide a complete summary of considerations that may apply to all mutual funds or intermediaries, but rather highlights certain considerations under the 1940 Act and other applicable laws and regulations.
- 3 Exemption for Open-End Management Investment Companies Issuing Multiple Classes of Shares; Disclosure by Multiple Class and Master-Feeder Funds; Class Voting on Distribution Plans, Investment Company Act Rel. No. 20915 (Feb. 13, 1995).
- 4 *Id.*
- 5 *Id.*
- 6 *Id.*; Exemption for Open-End Management Investment Companies Issuing Multiple Classes of Shares; Disclosure

by Multiple Class and Master-Feeder Funds, Investment Company Act Rel. No. 19955 (Dec. 15, 1993).

- 7 The adopting release for Rule 18f-3 noted that “[t]he proposal would have permitted only waivers or reimbursements by the fund’s adviser or underwriter of class expenses, and would not have permitted waivers or reimbursements for specific classes of fund expenses, such as advisory fees.” The adopting release further noted that “[d]espite the prohibition on differential waivers of fund expenses, [under the proposal] fund sponsors could have achieved the same result indirectly by waiving or reimbursing class expenses.” As a result, the adopting release deleted the restriction from the proposal and noted that the “modification is not intended to allow reimbursements or waivers to become de facto modifications of the fees provided for in advisory or other contracts so as to provide a means for cross-subsidization between classes.” Exemption for Open-End Management Investment Companies Issuing Multiple Classes of Shares; Disclosure by Multiple Class and Master-Feeder Funds; Class Voting on Distribution Plans, Investment Company Act Rel. No. 20915 (Feb. 13, 1995).

- 8 It should be noted that the reference to “classes” in Rule 22d-1 predates the development of Rule 18f-3 by several years. Accordingly, the reference should not be read to require a multi-class structure. Cf. *Mutual Fund Fee Structures*, IM Guidance Update No. 2016-06 (Dec. 2016), at n. 4.
- 9 See, e.g., *Portico Funds, Inc.* (pub. avail. Apr. 11, 1996) (SEC Staff agreed not to recommend enforcement action under Section 22(d) in connection with a program that offered benefits to banking customers who also had invested in a fund affiliated with the customers’ banks); *American Municipal Securities* (pub. avail. June 28, 1988) (SEC Staff agreed not to recommend enforcement action under Section 22(d) against a broker-dealer that proposed to offer discounts on its commissions for selling non-mutual fund securities when the proceeds of those sales would be invested in mutual funds and/or bonds); *Coleman Financial Services* (pub. avail. Apr. 17, 1987) (SEC Staff agreed not to recommend enforcement action to the SEC under Section 22(d) against a broker-dealer that proposed to offer discounts on its commissions for selling non-mutual fund securities when the proceeds of the sales would be invested in mutual funds).
- 10 Section 22(d) appears to support “retail price maintenance” (i.e., the determination of prices by manufacturers rather than distributors, possibly to encourage distributors to provide a certain level of service). Ultimately, Section 22(d) acts as a ban on price competition in sales charges. The history of the statute suggests that Congress intended to prevent three abuses that occurred in the distribution of fund shares prior to 1940: dilution of fund assets caused by riskless trading by insiders; disruption in the orderly distribution of fund shares; and unjust discrimination resulting from shareholders being charged different prices without a rational basis. See Exemption from Section 22(d) to Permit the Sale of Redeemable Securities at Prices that Reflect Different Sales Loads, Investment Company Act Rel. No. 13183 (Apr. 22, 1983) (proposing release). In the 1960s, Congress considered repealing Section 22(d), but ultimately deferred action pending an SEC study. Division of Investment Management, SEC, *Protecting Investors: A Half Century of Investment Company Regulation*, at 293 (May 1992) (“1992 Report”). In 1974, the SEC considered recommending a repeal of Section 22(d), but was met with opposition from FINRA and the mutual fund industry. As a result, the SEC proceeded to lay the groundwork for the orderly introduction of price competition in the sale of fund shares. Division of Investment Management Regulation, *Mutual Fund Distribution and § 22(d) of the Investment Company Act of 1940*, Report to the Senate Committee on Banking, Housing and Urban Affairs (Aug. 1974). For additional historical background related to Section 22(d), see 1992 Report, at 291-315; SEC Investment Company Act Release No. 8750 (Nov. 4, 1974).
- 11 Similar to Rule 22d-1, Rule 6c-10 permits deferred sales charges and imposes similar requirements as Rule 22d-1. Under Rule 6c-10, funds may impose deferred sales charges, subject to the following conditions: (i) the amount of the deferred sales charge does not exceed a specified percentage of the net asset value or the offering price at the time of purchase; (ii) the terms of the deferred sales charge are covered by the provisions of NASD Rule 2830 (now FINRA Rule 2341); and (iii) the same deferred sales charge is imposed on all shareholders, except that scheduled variations in or elimination of a deferred sales charge may be offered to a particular class of shareholders or transactions, provided that the conditions of Rule 22d-1 are satisfied.
- 12 See *Mutual Fund Fee Structures*, IM Guidance Update No. 2016-06 (Dec. 2016); Section II.A below.
- 13 See Exemption from Section 22(d) to Permit the Sale of Redeemable Securities at Prices that Reflect Different Sales Loads, Investment Company Act Rel. No. 13183 (Apr. 22, 1983) (proposing release).
- 14 Division of Investment Management, SEC, *Protecting Investors: A Half Century of Investment Company Regulation*, at 294-296 (May 1992) at 307-308.
- 15 *Mutual Fund Distribution Fees; Confirmations*, Investment Company Act Rel. No. 29367 (July 21, 2010) (proposing release) at 39, 90 (referred to as “account-level sales charges” or “externalized fee arrangements”).
- 16 *Id.* at 90.
- 17 *Id.* at 92-93.
- 18 *Bearing of Distribution Expenses by Mutual Funds*, Investment Company Act Rel. No. 11414 (Oct. 28, 1980).
- 19 Pursuant to Section 2(a)(42) of the 1940 Act, “voting securities” means any security presently entitling the owner of holder to vote for the election of directors. A “majority of the outstanding voting securities of a fund” means the vote of (i) 67 percent or more of the voting securities present at the meeting, if the holders of more than 50 percent of the outstanding voting securities of the Fund are present or represented by proxy, or (ii) more than 50% of the outstanding voting securities of the Fund, whichever is the less.
- 20 See, e.g., *Payment of Asset-Based Sales Loads by Registered Open-End Management Investment Companies*, Investment Company Act Rel. No. 16431 (June 13, 1988) (citing Investment Company Act Rel. No. 9470 (Oct. 4, 1976)) (proposing amendments, not subsequently adopted, that would have restricted the purposes for which amounts paid or payable under a Rule 12b-1 Plan, or a related agreement, may be used); *Prohibition on the Use of Brokerage Commissions to Finance Distribution*, Investment Company Act Rel. No. 26591 (Sept. 2, 2004) (adopting an amendment to Rule 12b-1, adding Rule 12b-1(h), which prohibits funds from compensating a broker/dealer for promoting or selling fund shares by directing brokerage transactions to that broker/dealer); *Mutual Fund Distribution Fees; Confirmations*, Investment Company Act Rel. No. 29367 (July 21, 2010) (proposing a new rule and rule amendments, not subsequently adopted, that would have replaced Rule 12b-1 with proposed new Rule 12b-2. Rule 12b-2 would have allowed funds to deduct a “marketing and service” fee from fund assets—up to 0.25 percent of net assets—to pay for distribution activities and would have imposed an asset-based ongoing sales charge subject to certain restrictions).
- 21 See, e.g., Letter from Douglas Scheidt, Assoc. Dir. And Chief Counsel, Div. of Inv. Mgmt., to Craig S. Tyle, Gen. Counsel, ICI, SEC No-Action Letter (Oct. 30, 1998) (“Supermarkets Letter”).
- 22 On June 28, 2016, FINRA Rule 2341 superseded NASD Rule 2830.

- 23 The cap on sales charges is based on a percentage of “new gross sales,” which do not include sales resulting from reinvestment of investment income or capital gains from exchanges of shares between funds in a complex of funds. Funds without asset-based sales charges are limited to a maximum aggregate sales charge that may vary from 6.25 percent to 8.5 percent of the offering price, depending on whether a service charge is levied, whether dividends may be reinvested at NAV, and whether quantity discounts, including rights of accumulation, are offered. Funds that levy an asset-based sales charge (not including any service fee) will have a cap on aggregate sales charges, including front-end, deferred or asset-based, that varies, depending on whether a service fee is levied, from 6.25 percent to 7.25 percent of total “new gross sales,” plus an interest rate applied to the asset-based charges, equal to the prime rate plus one percent per annum. The cap is applied on a continuous basis without annual or other periodic cut-offs.
- 24 FINRA has recognized that “service fees” for purposes of Rule 2341 envision payment for a much more limited set of services than the types of non-distribution services for which some investment companies pay under “shareholder servicing” plans. Accordingly, the types of shareholder services for which a fund may pay, and the level of shareholder servicing fees that may be deducted from a fund, are not strictly limited by Rule 2341; rather, to the extent a fund pays for the types of services contemplated by FINRA in Rule 2341’s service fees provisions, such payments are limited to 0.25 percent of the fund’s average daily net assets.
- 25 Robert Pozen and Theresa Hamacher, *The Fund Industry* (2015) at 13.
- 26 Investment Company Act Rel. No. 20915 (Feb. 23, 1995).
- 27 The master-feeder structure is another example of a fund structure that had been used to achieve similar objectives as a multiple class structure (and that did not require exemptive or no-action relief), but that was less-efficient than a multiple-class structure would be. A master-feeder arrangement is a two-tiered structure in which one more “feeder” funds invest all of their assets in the “master” fund.
- 28 Pozen & Hamacher, *supra*, at 13.
- 29 *Id.*
- 30 *Id.* at 110.
- 31 See, e.g., *Payment of Asset-Based Sales Loads by Registered Open-End Management Investment Companies*, Investment Company Act Rel. No. 16431 (June 13, 1988) at n. 173 and accompany text.
- 32 Pozen & Hamacher, *supra*, at 113; see also Corrie Driebusch, *The New ABCs of Mutual Funds*. *WSJ* (June 2, 2013).
- 33 See E.F. Hutton Investment Series, Inc., Investment Company Act Release Nos. 12079 (Dec. 4, 1981) (notice) and 12135 (Jan. 4, 1982) (order).
- 34 Pozen & Hamacher, *supra*, at 114. For example, after conversion to Class A shares, an investor would pay a lower Rule 12b-1 fee than he or she would have been paying to hold Class B shares.
- 35 Driebusch, *supra*, *WSJ* (June 2, 2013).
- 36 *Id.*
- 37 O’Neal, Edward S., PhD. *Mutual Fund Share Classes and Conflicts of Interest between Brokers and Investors*. Securities Litigation & Consulting Group. (2003) at 7; see also Pozen & Hamacher, *supra*, at 114.
- 38 Investment Company Act Rel. No. 29367 (July 21, 2010).
- 39 Investment Company Institute. *Navigating Intermediary Relationships* (Sept. 2009).
- 40 IM Guidance Update No. 2016-01. *Mutual Fund Distribution and Sub-Accounting Fees* (Jan. 6, 2016).
- 41 Pozen & Hamacher, *supra*, at 285.
- 42 Letter to Craig S. Tyle, General Counsel ICI, from Douglas Scheidt, Associate Director and Chief Counsel, SEC Division of Investment Management (Oct. 30, 1998) (“Supermarkets Letter”). This compensation may be paid by a fund, a fund sponsor or advisor, or distributor (or a combination thereof).
- 43 Abby Schultz, *Investing; Surprises in the Aisles of Fund Supermarkets*. *NY Times* (Jan. 17, 1999).
- 44 *Supermarkets Letter*, *supra*, at 4.
- 45 *Id.*
- 46 *Id.* at 7.
- 47 *Id.* at 8.
- 48 *Id.* at 8-9. In this letter, the SEC Staff recognized that “depending on the purpose of the payments and the party making the payment,” funds may pay intermediaries for non-distribution services pursuant to a 12b-1 Plan or outside of a 12b-1 Plan.
- 49 *Id.* at 10.
- 50 *Id.* at 11.
- 51 *Id.*
- 52 Pozen & Hamacher, *supra*, at 286.
- 53 Letter from John D. Dingell to Richard C. Breeden (Feb. 19, 1992).
- 54 Letter from John Dingell to Richard Breeden (April 14, 1992).
- 55 Letter from Richard Breeden to John Dingell (April 7, 1992); Letter from Richard Breeden to John Dingell (May 4, 1992).
- 56 Examination Priorities for 2014. SEC Office of Compliance Inspections and Examinations (Jan. 9, 2014).
- 57 Litigation Release No. 23273 (June 1, 2015).
- 58 Complaint, SEC v. Sage Advisory Group, LLC and Benjamin Lee Grant (D. Mass. filed Sept. 29, 2010).
- 59 *Id.* at para. 5.
- 60 Pozen & Hamacher, *supra*, at 301.
- 61 *Id.* at 114.
- 62 See *The Omnibus Revolution: Managing Risk Across an Increasingly Complex Service Model*, Deloitte & Touche LLP (2012).
- 63 See *Payment of Asset-Based Sales Loads by Registered Open-End Management Investment Companies*, Investment Company Act Rel. No. 16431 (June 13, 1988) (“The Commission did not include in rule 12b-1 a recitation of all the distribution activities that funds could finance under the rule. . . . The rule was intended to be flexible enough to cover new distribution

- financing arrangements that might be developed by the mutual fund industry.”); see also Investment Company Institute. *Navigating Intermediary Relationships* (Sept. 2009).
- 64 Mutual Fund Distribution and Sub-accounting Fees, IM Guidance Update No. 2016-01 (Jan. 2016).
- 65 See, e.g., *Payment of Asset-Based Sales Loads by Registered Open-End Management Investment Companies*, Investment Company Act Rel. No. 16431 (June 13, 1988) at n. 126, 129 and 173.
- 66 Investment Company Act Rel. No. 31832 (Sept. 21, 2015).
- 67 Investment Company Act Rel. No. 32621 (May 1, 2017); Investment Company Act Rel. No. 32624 (May 2, 2017).
- 68 Investment Company Act Rel. No. 32621 (May 1, 2017) at 3 (emphasis added).
- 69 *Id.* at 10.
- 70 *Id.* In total, the SEC found that William Blair had caused \$901,947 of fund assets to be paid for distribution and marketing services outside of a 12b-1 Plan. William Blair was ordered to pay a civil money penalty in the amount of \$45 million.
- 71 Investment Company Act Rel. No. 32624 (May 2, 2017) at 7.
- 72 *Id.* The SEC found that Calvert had caused \$14.87 million of fund assets to be improperly paid outside of a 12b-1 Plan for distribution and marketing services. The SEC ordered Calvert to pay disgorgement, prejudgment interest and a civil money penalty totality \$22,614,534. As part of undertaking to remedy this matter, the SEC’s settlement order obligated Calvert to take specific actions with respect to reimbursing affected shareholder accounts, notably submitting a disbursement calculation for review and approval by the SEC staff and conducting an “outreach process” with respect to intermediaries to assist in the calculation and disbursement. Please refer to the undertakings set forth in the SEC’s settlement order for a full recitation of these items.
- 73 IM Guidance Update No. 2016-01. *Mutual Fund Distribution and Sub-Accounting Fees* (Jan. 6, 2016).
- 74 *Id.* For a more detailed analysis of the Guidance Update, see SEC Staff Publishes its Views on Oversight of Certain Payments to Financial Intermediaries. Dechert OnPoint. (Feb. 2016).
- 75 Definition of the Term “Fiduciary”; Conflict of Interest Rule—Retirement Investment Advice. 81 FR 20946 (Apr. 8, 2016) (“Adopting Release”). For an in-depth discussion of the Fiduciary Rule, see *The Brave New Fiduciary World Has Arrived—The DOL Tries to Find a More Ideal Balance in the Final “Investment Advice” Rules*. Dechert OnPoint (May 2016).
- 76 *U.S. Chamber of Commerce v. DOL*, No. 17-10238, 2018 WL 1325019 (5th Cir. Mar. 15, 2018). At the time this article went to publication, the deadline for appeal had not yet expired.
- 77 Adopting Release at 20968.
- 78 *Id.* at 20970.
- 79 29 C.F.R. § 2510.3-21(b).
- 80 See *The Brave New Fiduciary World Has Arrived – The DOL Tries to Find a More Ideal Balance in the Final “Investment Advice” Rules*. Dechert OnPoint (May 2016) for a more in-depth discussion of these exceptions.
- 81 Best Interest Contract Exemption. 81 FR 21002 (Apr. 8, 2016).
- 82 As noted above, the Fiduciary Rule and Exemptions have been vacated by the Court of Appeals for the Fifth Circuit in *U.S. Chamber of Commerce v. DOL*. Accordingly, absent a ruling reinstating the Fiduciary Rule and the Exemptions, this compliance date would no longer be applicable.
- 83 See *The New DOL Fiduciary Rule: Impact on Mutual Fund Distribution*. Dechert OnPoint (Aug. 2016).
- 84 As noted above, the Fiduciary Rule and Exemptions have been vacated by the Court of Appeals for the Fifth Circuit in *U.S. Chamber of Commerce v. DOL*. Accordingly, absent a ruling reinstating the Fiduciary Rule and the Exemptions, this compliance date would no longer be applicable.
- 85 *Id.*
- 86 *The Brave New Fiduciary Rule has Arrived – The DOL Tries to Find a More Ideal Balance in the Final “Investment Advice” Rules*. Dechert OnPoint (May 2016).
- 87 Best Interest Contract Exemption, 81 FR 21002, 21012 (Apr. 8, 2016).
- 88 For further discussion of the impact on distribution through retirement plans, see *The New DOL Fiduciary Rule: Impact on Mutual Fund Distribution*. Dechert OnPoint (Aug. 2016) at 11-13.
- 89 See *The New DOL Fiduciary Rule: Impact on Mutual Fund Distribution*. Dechert OnPoint (Aug. 2016).
- 90 18-Month Extension of Transition Period and Delay of Applicability Dates; Best Interest contract Exemption (PTE 2016-01); Class Exemption for Principal Transactions in Certain Assets between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs (PTE 2016-02); Prohibited Transaction Exemption 84-24 for Certain Transactions Involving Insurance Agents and Brokers, Pension Consultants, Insurance Companies, and Investment Company Principal Underwriters (PTE 84-24). 82 Fed. Reg. 56545 (Nov. 29, 2017).
- 91 DOL Field Assistance Bulletin No. 2017-02 (May 22, 2017); but see *In re Scottrade, Inc.*, Mass. Securities Division (Feb. 15, 2018) (asserting that Respondent “knowingly violated its own internal policies designed to ensure compliance with the [Fiduciary Rule] by running a series of sales contests involving retirement account clients.”).
- 92 Notably, several states have adopted and proposed state-specific fiduciary statutes, some of which include written and/or oral disclosure requirements. See *Activist States Move Forward with Fiduciary Standards for Broker-Dealers and Investment Advisers*, Dechert OnPoint. (Apr. 2018).
- 93 Public Comments from Retail Investors and Other Interested Parties on Standards of Conduct for Investment Advisers and Broker-Dealers. Public Statement of SEC Chairman Jay Clayton (Jun. 1, 2017).
- 94 Testimony on Examining the SEC’s Agenda, Operation, and Budget (Oct. 4, 2017) (Statement by Chairman Clayton).
- 95 *U.S. Chamber of Commerce v. DOL*, No. 17-10238, 2018 WL 1325019 (5th Cir. Mar. 15, 2018). The court identified the following infirmities with respect to the Fiduciary Rule: (i) the Fiduciary Rule conflicts with the text of ERISA’s “investment advice fiduciary” provision and is inconsistent with the entirety

- of ERISA's fiduciary definition. Thus, particularly in light of a presumption in favor of a common-law analysis, the DOL "lacked statutory authority to promulgate the [Fiduciary] Rule with its overreaching definition" and (ii) the Fiduciary Rule, which reflects a "novel interpretation" that took the DOL "forty years to 'discover,'" is not a "reasonable" reinterpretation of the statute, and is an impermissibly "arbitrary and capricious" exercise of administrative power under the Administrative Procedure Act.
- 96 After Ruling, Fiduciary Rule Focus Shifts to SEC, Pensions & Investments (Apr. 2, 2018).
- 97 For a more detailed analysis of the state law activity with respect to the Fiduciary Rule, see *Activist States Move Forward with Fiduciary Standards for Broker-Dealers and Investment Advisers*, Dechert OnPoint. (Apr. 2018).
- 98 Maxey, Daisy. 5 Things Mutual-Fund Investors Should Know About Mutual-Fund 'T' Shares. WSJ (Apr. 9, 2017). Class T shares typically have other common features, including no exchange privileges or sales charge waivers.
- 99 In the Capital Group Interpretive Letter, the SEC Staff was loudly silent with respect to revenue sharing, noting specifically that the "letter does not address the effect under Section 22(d) of a broker receiving revenue sharing payments from the fund's adviser." Additionally, the Capital Group Letter did not contemplate sub-accounting or shareholder servicing payments. In contrast, Morningstar has advocated for a definition of clean shares that prohibits "[d]istribution fees, [a]dvise fees, [e]xternal sales charges, whether waived or not, and [a]ny payment that varies by how the fund is distributed (where purchased); amount invested (breakpoints, letters of intent or rights of accumulation, and so on); or who purchases the fund (eligibility)." See Comment Letter filed by Morningstar, Inc. in response to the DOL's July 6, 2017 Request for Information (Aug. 3, 2017). In addition, Morningstar has advocated that "clean shares should not include indirect payments of any kind to fund distributors, including third-party payments, revenue-sharing arrangements, platform fees, or finder's fee [sic]" and that "the department should not permit sub-transfer-agent fees when defining clean shares." *Id.* at 5-6.
- 100 Response of the Office of Chief Counsel Division of Investment Management (pub. avail. Jan. 11, 2017). See *Capital Group Companies, Inc.* (pub. avail. Jan. 6, 2017) for the request for interpretive guidance. See also, e.g., *Charles Schwab and Co., Inc.* (pub. avail. Aug. 6, 1992); *Linsco/Private Ledger Corp.* (pub. avail. Nov. 1, 1994); *U.S. v. NASD, Inc.*, 422 U.S. 694 (1975).
- 101 Securities Exchange Act of 1934, Section 3(a)(4)(A); see also Investment Company Act of 1940, Section 2(a)(6).
- 102 See also "Frequently Asked Questions on IM Guidance Update 2016-06 (Mutual Fund Fee Structures)" SEC Division of Investment Management (Feb. 15, 2017).
- 103 See Capital Group Letter at n. 8 (stating "This letter does not address the effect under section 22(d) of a broker receiving revenue sharing payments from the fund's adviser.")
- 104 See also "Frequently Asked Questions on IM Guidance Update 2016-06 (Mutual Fund Fee Structures)" SEC Division of Investment Management (Feb. 15, 2017).
- 105 See Capital Group Letter.
- 106 See PNC Clean Shares Platform, available at <https://www.pnc.com/en/personal-banking/investments-and-retirement/clean-shares.html>. The PNC website describes Clean Shares as a "[class] of shares that generally [has] lower ongoing fees and more transparent fee structures." Clean Shares are available for brokerage accounts offered through a PNC Investments Financial Advisor, and "PNC Investments charges a commission fee for each purchase and sale and the fund company charges ongoing operating expenses." The website contains a PNC Investments schedule of commissions and fees that a client may pay, including those applicable to Clean Shares.
- 107 See, e.g., Bradley Sachs. Schwab to Fund Shops: Keep Your 'Clean' Shares. Ignites (Feb. 22, 2018). See also, *supra* n. 99 and accompanying text.
- 108 Mutual Fund Fee Structures. IM Guidance Update No. 2016-06 (Dec. 2016). The SEC also clarified that, "[t]o add disclosure about sales load variations, a Fund will need to file the amendment to its registration statement under rule 485(a) under the Securities Act of 1933." *Id.* at 3.