Clock ticking for RIAs to self-report sales of high-fee mutual fund share classes

SEC offers favorable settlement terms through Monday to investment advisers who acknowledge they didn't use the lower-fee option available in a fund

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By **Mark Schoeff Jr.** , *Investment News* [subscription required]

The clock is ticking for investment advisers registered with the Securities and Exchange Commission to turn themselves in to the agency in a crackdown on costly mutual fund share classes.

The deadline is 12 a.m. eastern Tuesday for advisers to **report themselves** if they have put their clients in high-fee share classes when lower-fee options were available in the same fund.

Jim Lundy, partner at Drinker Biddle & Reath, anticipates many advisers will take advantage of the favorable settlement terms the SEC is offering to come forward.

"It's going to be a relatively sizable amount of firms," Mr. Lundy said. "It's going to be effective because they've gotten the attention of the industry."

Under the **SEC's Share Class Disclosure Initiative**, the agency is targeting advisers who have failed to disclose to clients that they have received revenue-sharing payments, or 12b-1 fees, to sell the funds. If the advisers report themselves, the agency will not impose a civil monetary penalty but will require advisers to return "ill-gotten gains" to clients.

If an RIA is still on the fence about self-reporting, the decision will have to be made within hours. They have to notify the SEC by midnight tonight by providing their name and contact information. More details about the violation would be provided through a questionnaire that's due in 10 days. Advisers can ask for an extension of the questionnaire deadline.

"It's incredibly late," Mr. Lundy said. "It's a difficult decision to make in the next [few] hours."

The initiative was announced in February.

The SEC implemented the initiative to address what it calls the widespread problem of investors being sold high-fee share classes when less-expensive alternatives were available.

"We've seen it from the smallest advisers to the biggest financial services firms," Steven Peikin, co-director of the SEC Division of Enforcement, told lawmakers at a **May 16 hearing** of a House Financial Services subcommittee.

Through self-reporting, the agency can obtain more investor restitution while preserving enforcement resources.

"I do think these self-reporting campaigns are successful," said Niels Holch, executive director of the Coalition of Mutual Fund Investors. "It's an efficient way to clean up a problem."

An SEC spokeswoman declined to comment on the number of advisers who have self-reported so far.

James Langston Jr., president of Fiduciary Integrity, a share-class-assurance consulting firm, doubts that advisers will jump at the chance to turn themselves in.

"Most investment advisers are not going to want additional scrutiny drawn to themselves," Mr. Langston said. "Most advisers aren't looking for that additional heat."

But it could be worse for them if they don't self-report, and the **SEC catches them later**.

"If they find firms who they think should have self-reported but didn't, they'll likely bring enforcement action against those folks," Mr. Lundy said.

The SEC initiative only applies to investment advisers registered with the agency, not to brokers — who are regulated by the Financial Industry Regulatory Authority Inc.

Brokers are more likely to take 12b-1 fees, according to Mr. Langston. Investment advisers can receive them, too, as long as they're disclosed, but more often avoid them because they must act in a client's best interests.

Brokers are held to a suitability standard that requires them to sell investment products that fit an investor's needs, but allows them to recommend those that generate the most revenue for themselves.

"RIAs, as a general rule, understand they have that fiduciary obligation," Mr. Langston said. "You run into more of these practices on the retail-brokerage side."