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Revenue-Sharing Disclosure Is Murky Area

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The lack of specific regulations from the SEC regarding revenue-sharing disclosures makes it a murky area for brokers to navigate.

Because brokers have been left to their own devices when it comes to disclosing revenue-sharing agreements, there is huge variety in terms of what they actually disclose. And while the number of disclosures is on the rise overall, what the firms disclose, where they disclose it and even why they disclose details of revenue-sharing agreements remains unique to each firm.

A **Morningstar** report from almost exactly a year ago by senior fund analyst Eric Jacobson called for more disclosures. He said a rule proposed by the SEC in January 2004 would do just that, requiring brokerages to detail all the fees they get, including loads, asset-based sales charges, service fees and revenue-sharing costs. At the time, he said that would make it easier for investors to determine whether a broker is pushing a particular fund because of the payment rather than the quality of the investment.

However, this rule is still up in the air.

Niels Holch, executive director of the **Coalition of Mutual Fund Investors**, says new SEC chairman Christopher Cox has yet to address mutual fund issues, "so it's still sort of unclear what the SEC will do."

Nevertheless, brokers have made disclosures of their own volition, and they have done so in increasing numbers. Holch's organization also favors more disclosures as well as a certain degree of standardization.

In broad terms, Holch says standardization is a trade-off: "Each mutual fund has its own sets of policies, procedures, investment strategies... each is unique in what they present to the public. If you take a cookie-cutter approach to the mutual fund, I don't know if that's in the interest of the investor," he says.

But the motivation behind making such disclosures is unclear.

Jay Baris, an attorney with **Kramer, Levin, Naftalis & Frankel**, says there is definitely a trend toward brokers disclosing more information. He cited cases against broker-dealers in which they were alleged to have not disclosed conflicts of interest relating to payments they received from fund companies for distributing shares.

For example, **Edward Jones** reached a tentative \$75 million settlement with the SEC, NASD and the NYSE resolving charges that it failed to properly disclose revenue-sharing arrangements with mutual funds in late 2004. **Morgan Stanley** was hit with a \$50 million settlement a year prior for such practices.

And, according to Baris, this has resulted in concern among brokers about disclosing conflicts of interest.

In April of last year, **A.G. Edwards** was also hit by an investor lawsuit of alleged revenue-sharing arrangements with mutual fund companies. The plaintiffs claimed the brokerage was taking money from funds on a preferred list without disclosing the deals to customers.

Jeff Keil, principal of **Keil Fiduciary Strategies**, says litigation has likely enhanced the quality of disclosures simply because it facilitated the review of disclosures.

Exactly where the disclosure appears also differs. Some firms, like A.G. Edwards, post statements on their websites. According to an A.G. Edwards spokeswoman, "We posted our information in December 2005 to provide our clients

with a better understanding of the business relationships that are in place with the companies with which we do business.”

Paulita Pike, a partner with law firm **Bell, Boyd & Lloyd**, explains, “There are many who have taken the position that sunlight is the best disinfectant,” meaning that it behooves firms to be forthright.

Mercer Bullard, founder of the shareholder advocacy group **Fund Democracy**, says the future of revenue-sharing disclosures depends on what happens at the federal and state level. In terms of claims against firms that have provided inadequate disclosures, Bullard cites California, New Hampshire and Massachusetts and says, “The SEC has no initiative. It’s been sitting on its hands for several years. The states have tried to pick up some slack by bringing cases against fund distributors...”

But whether or not states have the jurisdiction “or the SEC will find reason to do its job” remains to be seen, Bullard adds.

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