Finders’ Fees for Fund Sales Worth Directors’ Attention

By Whitney Curry Wimbish, *BoardIQ*, August 14, 2018 [subscription required]
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When it comes to making large fund purchases, the institutional share class isn’t an investor’s only option. Sometimes, bigger investors want the shareholder servicing component that other classes come with.

In those cases, a fund may create a special arrangement that eliminates the sales charge for investors making a large purchase. In its place, though, the investor may have to pay a deferred sales charge, which the adviser can use to pay a finder’s fee to the broker-dealer.

As boards continue to keep an eagle eye on money flowing from the adviser and distributor to intermediaries, these deferred sales charges and finders’ fees may be worth checking on, experts suggest.

Directors may want to ask how their funds sell load-bearing shares to large investors, whether those sales include special fees, how those fees are benchmarked, and how much they bring in for the adviser, experts say. They may also want to ask how the fees figure into the overall picture of payments made to intermediaries – an area for which the Securities and Exchange Commission says funds lack specific compliance policies and procedures.

A recent filing from the **Aberdeen Funds** illustrates this type of sale.

In a disclosure made last month, Aberdeen describes how there are no sales charges for A shares when purchases are $1 million or more for some funds or $250,000 or more for others.

But in certain cases, the investor would have to pay a contingent deferred sales charge if redeeming the shares within 18 months of purchase.

The distributor or the funds’ adviser may pay dealers a finder’s fee on A-share purchases with no initial sales charge; the contingent deferred sales charge covers the finder’s fee paid by the distributor or adviser to the selling dealer.

The finder’s fee is determined by the particular funds purchased; the contingent deferred sales charge is determined according to the amount redeemed from each particular fund.

The Aberdeen disclosure shows that the finder’s fee and deferred sales charges are between 0.75% and 1% for purchases of between $1 million and $4 million.

They are 0.50% for purchases between $4 million and $25 million. And for $25 million or more, they are 0.25%.

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[Since the SEC guidance was issued, fund boards] began receiving new reports on intermediary fees that showed all the payments intermediaries receive from the fund and the adviser for every share class of every fund. As part of the ongoing process to keep up to date on those fees, experts say, directors may want to determine whether there are ones like the finder’s fee that may take place infrequently during the year. They may want to double-check that the fee is coming out of the adviser’s pocket, not the fund’s.

And they may want to delve into the details. Directors could ask, for example, about the frequency of finders’ fee payments and how the timing of the contingency deferred sales charge works, says Niels Holch, executive director of the Coalition for Mutual Fund Investors and a founding partner of **Holch & Erickson**.

If a policy were to mirror Aberdeen’s, for example, a director could ask about timing.

“The shareholder is subject to a contingent deferred sales charge if he or she redeems in 18 months,” he says. “Does that mean the broker has to wait 18 months to get the upfront replacement sales charge?”

And, he asks, what happens if the investor holds on to the shares long-term? How does the adviser compensate the broker in that scenario?

“If the contingency isn’t realized, then what happens?” Holch says. “The broker gets paid either way.”