Regulators showing renewed interest in cracking down on investment fees

SEC, Finra targeting high-fee share classes, 12b-1 fees and failure to give sales load discounts and waivers to investors

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Regulators are putting increasing pressure on financial advisers who try to augment their income by putting clients in high-fee funds or ones that offer revenue sharing.

Recently, the Securities and Exchange Commission and the Financial Industry Regulatory Authority Inc. have demonstrated that they're on the hunt for opaque fees.

Earlier this week, the SEC filed a complaint against a Connecticut investment adviser who invested his clients in mutual fund share classes with 12b-1 fees when share classes in the same fund without the fees were available. In September, the SEC reached a $3.5 million settlement with UBS in a case involving the sale of high-fee share classes.

Last week, Finra noted in its summary of 2017 exam findings its concern about brokers recommending high-fee share classes without determining whether they're suitable for their clients.

The regulators have long been worried about these issues, which also encompass situations where customers do not receive appropriate sales load discounts and waivers.

But there is now a renewed urgency thanks in part to a greater focus on fees brought about by the Labor Department's fiduciary rule and a trend toward passive investing.

"The regulatory bodies believe that the all-in cost of retirement is too high," said Whitfield Athey, chief executive of Delta Data, a mutual fund back-office technology firm. "Anytime there is an opportunity to assess fines on fees, they're doing it."

Revenue sharing, where a fund firm pays an intermediary, such as a broker or investment advisers, for marketing the fund is becoming especially vulnerable to enforcement.

"They're regulating revenue-sharing out of existence by using lack of disclosure as a regulatory charge," said Todd Cipperman, principal at Cipperman Compliance Services. "It doesn't seem that any disclosure is enough."

The regulatory crackdown is wide-ranging, according to Niels Holch, executive director of the Coalition of Mutual Fund Investors. It is helping to make a reality a recent warning by SEC Chairman Jay Clayton about fee disclosure.

"What we're seeing is broader than a crackdown on share classes," Mr. Holch said. "They're looking at all hidden and inappropriate fees paid by individual investors."

The Investment Company Institute said that as of October, 85% of new fund sales involve those with no loads and no 12b-1 fees. The ICI is a trade association representing the mutual fund industry.

But for decades, advisers have been recommending high-fee funds to their clients, and that legacy could now get them into trouble.

"There is still a lot of money in expensive, and often underperforming, mutual funds in part because advisers have a long relationship with these strategies," said Todd Rosenbluth, director of exchange traded fund and mutual fund research at CFRA, an independent fund-rating company. "There's going to be a greater occurrence of clients complaining about this. Investors are more fee-conscious than they have been in the past."

That means that high-fee funds will remain in the regulatory firing line.

Regulators "think they have them in a corner," Mr. Athey said. "They're going to keep pounding on them until they go away."

In order to stay out of the fray, advisers have to assess the sources of their revenue.

"If it comes from anywhere other than the disclosed advisory fee you're charging clients, you really should reconsider that business model," Mr. Cipperman said.