SEC warning could lower mutual fund fees paid to brokers

The agency issued guidance to directors saying they should install a process to evaluate whether administrative fees are being used to encourage distribution.

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

The Securities and Exchange Commission is warning mutual fund directors to look more closely at fees the funds pay brokers and other intermediaries who use them in investor portfolios.

In guidance posted on the SEC website, the staff of the Division of Investment Management said a recent sweep examination showed fees that are purportedly for administrative services — such as recordkeeping, answering customer questions and providing account and tax statements — are instead being used to encourage sales of the funds.

Under SEC rules, the so-called sub-accounting fees cannot finance distribution. The distribution fees must be outlined in a 12b-1 fee. The problem, the SEC said, is that in omnibus accounts maintained by mutual funds, all the fees are mixed together and payments to brokers encouraging them to sell a particular fund can be disguised as administrative fees.

The SEC told fund directors to “pay particular attention” to fees paid to intermediaries for account servicing if they're also selling the funds. That could mean brokers will see smaller payouts from funds.

“This [guidance] is going to cause fund boards to take a sharp pencil to their fees,” said Niels Holch, executive director of the

Coalition of Mutual Fund Investors. “That will affect part of the distribution relationship brokers have with funds.”

INVESTOR RETURNS

The SEC staff said mutual fund directors should put in place a process to evaluate whether sub-accounting fees are being used to boost sales. It also said advisers and service providers to the fund should explain the details of distributions and servicing clearly to fund directors.

The agency is concerned that what it calls **payments for distribution in disguise** could harm investors.

“Mutual fund fees have a direct impact on investor returns,” the **SEC guidance** states. “For example, because investors may evaluate funds based on the specific levels of 12b-1, management and other fees, potential mischaracterization of fees may lead them to invest in funds that they would not otherwise have selected.”

An investor advocate said the guidance will help fund directors sort out the myriad fees attached to funds.

“The guidance is really a significant step forward to clarify the standards for evaluating sub-accounting fees … [and] protect investor interests,” Mr. Holch said.

The interest group that represents fund directors welcomed the SEC's direction.

“This detailed document will provide guidance for boards and for advisers struggling to apply the previous decades-old staff guidance to today's vastly different distribution environment,” Susan Ferris Wyderko, president and chief executive of the Mutual Fund Directors Forum, said in a statement.