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Shops Ditch B Shares As Class Nears Extinction

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B shares have taken yet another step toward extinction as at least two firms have announced they are eliminating the embattled share class partially or entirely from their lineups.

Recent regulatory filings show that **Wells Fargo** and **Bank of America**'s **Columbia** unit both plan to phase out B shares in the first quarter of 2008.

In a Dec. 17 filing, Wells Fargo said it will close all B shares to new investors and additional investments from existing shareholders by the end of the first quarter of 2008. Another filing dated Dec. 18 shows that the Columbia Acorn funds, will no longer accept investments in B shares from new or existing investors beginning Feb. 29, 2008.

"The need for B shares has greatly diminished," says Wells Fargo spokesman Peter Greenley. "New mutual fund classes and other types of investment programs have been developed to serve investors that previously may have been served by B shares." Columbia Acorn spokeswoman Marilyn McCarthy says ditching B shares makes sense because the investment minimums on the Acorn funds far exceed Columbia's $50,000 cap on B shares.

According to **Financial Research Corp.**, sales of B shares fell to about 3% of total fund sales last year.

Still, B shares are not yet extinct. "The sale of B shares has been scaled back and the policing has been better, but most broker-sold shops still have them," says Russ Kinnel, director of research at **Morningstar**. "If brokers still want them, they'll continue to exist."

The latest moves to eliminate them are not surprising, however, given the stigma attached to B shares in the wake of dozens of enforcement actions imposed against fund companies and broker-dealers for inappropriate sales practices. Wells Fargo was fined $3 million in 2005 for providing brokers incentives to place their clients in B shares.

At issue was brokers selling B shares when it would have been more cost effective for their clients to purchase A shares because they would have qualified for breakpoint discounts.

Some brokers recommended transactions in B shares that were so frequent that it triggered contingent deferred sales charges (CDSCs), or back-end loads. Both scenarios generated higher compensation for the brokers selling the funds.

B shares don't carry an up-front load like their A-share counterparts but tend to have higher 12b-1 fees, transaction costs and a back-end load levied when the shares are sold within a certain number of years.

In 2005, **Ameriprise**, **Citigroup**, **JPMorgan Chase**, **Merrill Lynch**, Wells Fargo and **Linsco/Private Ledger** were fined a total of $40 million for unsuitable B- and C-share sales. Each shop was hit with fines for steering customers into certain funds without telling them that those funds did not offer the best possible returns.

Some fund companies, such as **Franklin Resources**, have eliminated B shares altogether. Others, such as **Fidelity** and Columbia, have put a cap on the number of B shares that can be purchased in a single transaction.

"If more firms are shutting down their B-share classes, that will serve as a further nail in the coffin," says Mark Perlow, partner at **K&L Gates**. Economically, it doesn't make a lot of sense to promote B shares given that they account for less than 5% of total sales, he says.

However, Perlow argues that, in theory, they can be a suitable client offering. "There is considerable evidence that B shares are still a good investment for small investors because they're not paying an up-front sales load of 5.75%."

Attorneys who have defended firms in these cases say the enforcement actions have had some unintended consquences. "It's the classic example of regulation through enforcement," says Brian Rubin, a partner at law firm **Sutherland, Asbill & Brennan** in Washington, D.C. "B shares had a legitimate purpose for some clients. With adequate disclosure, they could have been reasonable investments."

Despite the shrinking market for B shares, many of the broker-sold shops still have them in their stable for those brokers who don't mind the negative connotation. "They may exist, but they're not being marketed," says Niels Holch, president of the **Coalition of Mutual Fund Investors**.

Fear of regulatory intervention, whether it is warranted or not, is enough to keep most firms from relying on B shares as a significant source of revenue. "It's kind of hard to make the case for B shares. The huge amount of abuses outweighed the modest benefit," Kinnel says.

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