

SEC Proposes Limits On Funds' 'Ongoing Sales Charges'

By Fawn Johnson, Of DOW JONES NEWSWIRE

WASHINGTON -(Dow Jones)- The U.S. Securities and Exchange Commission is set to approve a new proposal Wednesday to limit ongoing sales charges from mutual funds and require them to disclose that certain fees charged to investors are for marketing purposes.

The proposal would restrict ongoing sales charges to "the highest fee charged by the fund for shares that have no ongoing sales charge," according to an SEC summary.

"For example, if one class of the fund charges a 4% front-end sales charge, another class could not charge more than 4% in total to investors over time," the summary said.

Since 1980, the SEC has allowed mutual funds to pay for some or all of the services that third-party financial advisers provide through so-called "12b-1 fees," which are deducted from fund assets over time.

Named for the rule codifying the law, 12b-1 fees can be used to pay for sales, marketing and other promotion activities. They also are used to compensate intermediaries like retirement plan recordkeepers and discount brokerage firms.

Before 1980, the only way to compensate a financial adviser for selling a mutual fund to a customer was through a front-end, one-time payment from the mutual fund buyer. 12b-1 fees were originally conceived as a way to pay brokers for selling "no-load" fees that don't have any upfront costs for the customer.

SEC Chairman Mary Schapiro says 12b-1 fees aren't well understood by investors. But those fees amounted to \$9.5 billion in 2009 and exceeded \$13 billion in 2007, compared to just a few million dollars in 1980.

The SEC's rule calls on mutual funds to disclose when the funds are being used to market the fund to other investors. The fund would have to disclose any "ongoing sales charges" and any "marketing and service fees" in the fund's prospectus, shareholder reports and investor transaction confirmations, the summary said.

In 2005, the Investment Company Institute, which represents mutual funds, said the bulk of 12b-1 fees were used to compensate financial advisers for initial sales and ongoing shareholder services. Only 2% of those fees go to marketing, ICI said.

The SEC also is set to approve Wednesday long-awaited rules requiring investment advisers to give clients narrative brochures containing "plain English descriptions" of the advisers' businesses, services and conflicts of interest.

The rule expands the content the brochures will cover to include things like performance-based fees, methods of analysis, codes of ethics and brokerage practices.

Investment advisers are grateful to see the change toward a more user friendly disclosure device.

"We've been advocating that the SEC finalize this rule for 10 years," said Investment Adviser Association General Counsel Karen Barr. "This is critically important for clients," who will get upfront disclosures about advisers' compensation, conflicts of interest, and disciplinary sanctions.

The SEC's rule comes the same day President Barack Obama signs a sweeping financial-overhaul bill that puts in place a new consumer protection bureau to curb market abuses and help retail investors decode the complex financial world.

SEC Chairman Mary Schapiro, meanwhile, has said she wants agency staff to make sure all public companies' disclosures are concise and easy to understand.

Putting legal disclosures into readable narratives poses some challenges for companies. "There tends to be pushback from attorneys," said Deborah Bosley, a University of North Carolina English professor who consults with companies on clarifying their corporate filings. "Attorneys are used to their own language. They're comfortable with their own language. Part of the issue now is getting them more comfortable with transparent language that is still legal."

Bosley predicted the SEC's new rule will help investment advisers win trust from their clients that may have tarnished in the financial crisis. "Some of these investment houses are going to grab onto this as a marketing opportunity," she predicted.

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