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# Classes and Conflicts: What's Next for Fund Distribution Arrangements?

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The once-ubiquitous lineup of mutual fund share classes has experienced significant disruption that shows no signs of abating. Mutual funds generally continue to face substantial outflows and downward fee pressure, and Securities and Exchange Commission (SEC) enforcement activity in late 2019 has further destabilized traditional class-level fee and expense arrangements, including distribution fees paid pursuant to Rule 12b-1 (Rule 12b-1) under the Investment Company Act of 1940 (the 1940 Act).[1] More radically, they have also challenged long-standing investment adviser revenue sharing practices. These enforcement actions come in the wake of the SEC's June 2019 adoption of an interpretation of the fiduciary duties required of investment advisers (the Fiduciary Interpretation),[2] and like the Fiduciary Interpretation, they focus heavily on advisers' compliance with their fiduciary duties around conflicts of interest. These actions also come in the present moment of a decades-long debate across the federal government about the appropriate allocation of mutual fund distribution costs, protection of retirement and other retail shareholders, and investment adviser duties, especially where affiliated broker-dealers are involved.[3]

After providing historical context, this article summarizes recent SEC's enforcement activities—including litigation, settlements, Staff guidance, and priorities for 2020—that illustrate the regulatory mousetrap that investment advisers face today. In conclusion, we pose a series of business and legal questions that advisers and fund boards might consider as they look to the future.[4]

## From Single Class 12b-1 Plans to Share Class Selection Amnesty

Since the SEC adopted Rule 12b-1 in 1980[5] after lengthy dialogue among regulators about the appropriateness of mutual fund shareholder assets being used for sales loads and commissions,[6] the SEC Staff has repeatedly revisited the issue. Amendments were proposed to Rule 12b-1 in 1988 that, among other things, would have required a fund's 12b-1 fees to be linked to specific distribution services and its 12b-1 plan to be approved annually by shareholders.[7] The proposed amendments, which were not adopted, reflected SEC concerns that industry practices undermined the role of independent trustees in overseeing Rule 12b-1 plans, did not adequately mitigate or disclose the conflicts of interest associated with the payment of 12b-1 fees to affiliated broker/dealers, and did not provide sufficient disclosure about the nature of 12b-1 fees and their impact on returns.[8] Rule changes that were adopted in 1988 mandated that mutual fund prospectus fee tables disclose the amount of any Rule 12b-1 fees paid by a fund,[9] and changes adopted in 1994 enhanced the disclosure requirements for mutual fund proxy statements soliciting shareholder approval of Rule 12b-1 plan proposals.[10]

Then in 1995, the familiar retail share classes—Classes A, B, and C—and their differing expense structures emerged following the SEC's adoption of Rule 18f-3 under the 1940 Act, which allowed funds to offer multiple share classes with different fees and expenses,[11] and Rule 6c-10 under the 1940 Act, which allowed funds to impose contingent deferred sales charges and vary or eliminate sales charges for different share classes.[12] As the shift from direct-at-fund to third-party intermediated omnibus sub-accounting gained steam and the blurry distinction between distribution and shareholder service costs grew even more opaque,[13] in 1998 the SEC Staff released its "fund supermarket" no-action letter.[14] Addressing "administrative service fees" paid to third-party intermediaries out of fund assets, the SEC Staff identified services that fund boards should consider to be "primarily intended to result in the sale of fund shares" such that fund assets other than Rule 12b-1 fees could not be used, directly or indirectly, to cover the cost of the services.[15]

While the fund supermarket letter seemed to provide clear guidance at the time it was released, in the increasingly digital and intermediated distribution environment of the early 2000s concerns again arose that mutual fund assets were being used to cover "shelf space" and other distribution costs outside of Rule 12b-1 plans. A roundtable held by the SEC in 2007 aired calls for modernization and reform, and Rule 12b-2 was proposed in 2010.[16] Rule 12b-2 would have repealed Rule 12b-1 in its entirety and, among other significant changes, would have essentially limited to 0.25 percent the amount of fund assets that could be used to cover distribution-related costs. The industry balked hard, and Rule 12b-2 died on the vine. However, the SEC Staff did not give up. Among its examination priorities for 2013, the SEC's Office of Compliance Inspections and Examinations (OCIE) announced a "distribution in guise" initiative and began actively searching for distribution-related payments made by funds to ostensibly cover the costs of sub-transfer agency, sub-accounting, recordkeeping and other administrative shareholder services.[17]

In 2016, the market and regulatory pressure on status quo fund fee and expense arrangements intensified sharply as:

- The SEC's Division of Investment Management, informed by findings from the 2013 OCIE initiative, released updated guidance identifying fee and expense arrangements that the SEC Staff would view as indicia of distribution fees in disguise;[18]
- Fund share classes sans sales loads and Rule 12b-1 fees[19] began to proliferate due to the rising preference for lower cost, passively managed products, the almost complete transition to third-party intermediated omnibus sub-accounting, and the industry's tectonic response to the once-looming compliance date of the now-defunct US Department of Labor fiduciary rule;[20] and
- OCIE gave notice of a new sweep exam focused on advisers' conflicts disclosure and compliance with fiduciary duties around share class recommendations in "situations where the adviser is also a broker-dealer or affiliated with a broker-dealer that receives fees from sales of certain share classes, and situations where the adviser recommends that clients purchase more expensive share classes of funds for which an affiliate of the adviser receives more fees" (the OCIE Share Class Initiative).[21]

With learning from the OCIE Share Class Initiative in hand, and on the heels of the announcement of its 2018 priorities,[22] in February 2018 the SEC's Division of Enforcement launched a Share Class Selection Amnesty Initiative (the Amnesty Initiative) that offered standardized, favorable settlement terms, including a promise of no civil penalty, to eligible advisers that self-reported by June of that year their improper selection of mutual fund share classes with Rule 12b-1 fees for clients when lower-cost share classes were available to the clients.[23] Outside of the Amnesty Initiative, several December 2018 SEC settlement orders alleged that without adequate disclosure and in violation of their fiduciary duties, including the obligation to seek best execution under Section 206 of the Investment Advisers Act of 1940 (the Advisers Act), advisers had placed clients in mutual fund share classes with Rule 12b-1 fees when less expensive share classes of the same funds were available.[24]

In the Spring of 2019, the SEC announced settlements with 79 investment advisers participating in the Amnesty Initiative, ordering the payment of more than an aggregate $125 million in disgorgement and interest to investors.[25] Later that year, the SEC announced an additional 16 settlements under the Amnesty Initiative with an aggregate $10 million in disgorgements due.[26] The SEC also announced a settlement with an adviser that was eligible to but did not self-report; the firm was ordered to pay $1 million in disgorgement and interest plus a $300,000 civil penalty.[27] In alleging that the advisers in these cases violated the fiduciary duties, the orders simply point to evidence, for example, that the adviser purchased, recommended, or held for advisory clients mutual fund share classes that charged Rule 12b-1 fees instead of lower-cost share classes of the same funds for which the clients were eligible and failed to disclose the related conflicts of interest.[28]

## Fiduciary Interpretation, Revenue Sharing, and Frequently Asked Questions

Still, it is the SEC's enforcement actions around the once-unquestioned practice of revenue sharing[29] that perhaps most glaringly illustrates the intense regulatory pressure on fund distribution and adviser compensation arrangements. While these cases, which are summarized below, also concern the adequacy of disclosure regarding the conflicts of interest associated with Rule 12b-1 fees, their emphasis on conflicts disclosure regarding adviser revenue sharing arrangements is relatively novel. These cases follow the SEC's adoption of the Fiduciary Interpretation on June 5, 2019 and highlight compliance pitfalls that advisers should avoid and fund boards should be aware of in overseeing fund service providers and distribution arrangements.[30]

- On August 1, 2019, the SEC charged a dual-registered investment adviser and broker-dealer with failing to disclose material conflicts of interest regarding revenue sharing received by the adviser for investing clients in certain share classes of certain mutual funds.[31] The adviser allegedly had a revenue-sharing agreement with an unaffiliated broker through which, when the adviser purchased or sold certain "no-transaction-fee" fund shares for its clients, the client did not pay upfront transaction fees but did pay ongoing Rule 12b-1 fees to the unaffiliated broker-dealer, who would then share a portion of those payments with the defendant. The SEC claimed that while the adviser disclosed some aspects of the conflicts of interest raised by its revenue sharing agreements, it described them as "potential," which the SEC characterized as misleading given that the adviser's financial incentives created an actual conflict of interest.

  According to the SEC's complaint, the revenue-sharing arrangement at issue created a number of differing financial incentives for the adviser when recommending mutual funds to its advisory clients, including that some fund share classes were less expensive than those that generated revenue sharing payments for the adviser. In addition, the SEC asserted that the adviser had a disincentive to recommend certain mutual funds available to its advisory clients that were not covered by a revenue sharing arrangement. The SEC alleged that the adviser breached its fiduciary duty under Section 206 of the Advisers Act by failing to disclose these differing financial incentives. More appropriate disclosure, according to the SEC, would make clear that even "no-transaction-fee" share classes could generate ongoing revenue sharing payments to the adviser and that share classes that did not involve revenue sharing with the adviser were available.

The adviser's response to the SEC argues that the SEC has not formally addressed revenue sharing disclosure and that to attempt to "retroactively impose uncabined duties" through litigation, among other things, violates the due process that advisers should be afforded.[32] The court's ultimate resolution of these issues will be instructive, but will not establish binding precedent for or against the SEC's position on revenue sharing, absent years of potential appeals and further litigation.

- In a separate suit, the SEC alleged that a dual-registered investment adviser and broker-dealer defrauded and breached its fiduciary duty to clients when it, without appropriate disclosure and despite the availability of other funds, the adviser funneled clients towards funds covered by a revenue sharing arrangement through which it received payments from its clearing broker.[33] Also of note, in addressing the adviser's alleged placement of clients in share classes with Rule 12b-1 fees "even when it knew these clients were eligible to invest in lower-cost shares of the same funds without 12b-1 fees," the SEC Staff has emphasized that investors in the higher-cost but "otherwise identical share classes paid additional compensation" to the adviser for as long as the clients held the investment.
- On September 19, 2019, the SEC settled with an adviser that allegedly failed to disclose multiple conflicts related to mutual fund share class selection and the receipt of revenue-sharing payments.[34] As stated in the SEC's order, the adviser violated its fiduciary duties by failing to disclose the inherent conflict in recommending fund share classes with Rule 12b-1 fees where the adviser and/or its affiliates receive a portion of the fee from the clearing broker. Significantly, the adviser also was alleged to have breached its fiduciary duties when it did not disclose to clients that, for share classes with Rule 12b-1 fees, it was not required to pay its clearing broker an asset-based fee that would have otherwise been due.
- A week or so later, the SEC settled with two affiliated advisers that were alleged to have, without disclosure about the related conflicts of interest, consistently selected for clients (a) proprietary funds that resulted in the payment by investors of additional management fees, and (b) higher-cost, retail share classes with Rule 12b-1 fees when lower-cost institutional share classes of the same funds were available to those clients.[35] "By selecting the higher-cost share classes," the SEC reported, the adviser "received revenue sharing payments and avoided paying certain transaction costs, while clients received lower returns on these investments."

On October 18, 2019, the Staff of the SEC's Division of Investment Management released a set of frequently asked questions (FAQs) touching directly on the potential financial conflicts that advisers may face with respect to their compensation.[36] The informal guidance reinforces that the SEC Staff views the framework reflected in the enforcement actions described above as a restatement of current law rather than a new set of obligations. But at the same time, the guidance goes beyond the facts of recent enforcement proceedings, addressing all manner of financial benefits accrued to advisers and their affiliates. As the guidance explains:

> While the FAQs illustrate the application of these disclosure obligations in the context of certain types of compensation that investment advisers receive, such as 12b-1 fees and revenue sharing, many of the same principles and disclosure obligations apply to other forms of compensation. These may

> include, among other forms of compensation, an investment adviser's direct or indirect receipt of service fees from its clearing broker-dealer, marketing-support payments from a mutual fund's investment adviser, transaction fees, or receipt of payments from a mutual fund's investment adviser to help defray the costs of educating and training its personnel regarding certain investment products. Depending on the nature of the compensation, the resulting financial incentives would give rise to conflicts relating to, for example, the types of investments, the fund families, the particular funds and the share classes of individual funds that the adviser recommends, as well as the extent of trading it recommends…Market practices evolve regularly, including with respect to compensation arrangements and fund sales practices more generally. Accordingly, the Staff encourages investment advisers to be proactive in reviewing their practices concerning the compensation that they, their affiliates or their associated persons receive in connection with the investments they recommend and related services they provide to identify conflicts of interest regardless of whether we specifically identify those practices.[37]

The SEC Staff goes on to imply that, under certain circumstances, advisers should rebate sales loads, Rule 12b-1 fees, and/or revenue sharing payments by guiding advisers to disclose any practice of "offsetting or rebating some or all of the additional costs to which a client is subject (such as 12b-1 fees and/or sales charges), the impact of such offsets or rebates, and whether that practice differs depending on the [type] of client, advice, or transaction." The FAQs also offer examples of material facts related to share class conflicts and revenue sharing practices, as well as factors that advisers should consider in crafting their disclosures on Form ADV. However, the Staff cautions that it does not view the examples as comprehensive and is not providing "model or preferred disclosure language for the compensation arrangements discussed."[38]

## Fund Distribution and Adviser Compensation in the New Decade

Mutual fund share class arrangements continue to evolve as competitive market forces intertwine with preparations for the upcoming compliance dates of Regulation Best Interest (Reg BI) and Form CRS[39] and the universe of lower-cost exchange-traded funds (ETFs) stands to expand even further with the new SEC rule that lifts the burden of obtaining an exemptive order to launch certain types of ETFs[40] and the SEC's grant of exemptive relief that effectively permits non-transparent actively managed ETFs to operate under certain conditions.[41]

SEC filings and reports from industry associations, news media, and consultants show that: retail mutual fund share classes generally continue to suffer persistent outflows; front-end sales loads are waived almost uniformly on Class A shares; Class B shares are all but extinct; and Class C shares are converting to lower-cost Class A shares on accelerated schedules.[42] As model asset allocation products and retirement and other institutional mutual fund share classes are garnering inflows, some fund firms are slashing and even eliminating Rule 12b-1 fees on retail classes.[43] Other firms are moving towards offering in their primary distribution channels a single class of shares that is free of sales charges and Rule 12b-1 fees.[44] And, the updated research analyst ratings methodology announced by Morningstar, Inc. (Morningstar) has the potential to further highlight the impact of asset-based loads and fees on the returns enjoyed by retail investors. As Morningstar reports, "previously, we assigned the same rating to all a fund's share classes, fee differences aside. Now we're tailoring ratings to each share class by taking its specific fees into account. Thus, costlier share classes see lower ratings in some situations."[45]

Meanwhile, the SEC remains highly attuned to mutual fund distribution and adviser compensation arrangements. Director of the SEC's Division of Investment Management, Dalia Blass, speaking in late 2019, reported that the Staff is considering ways to update fund fee disclosures to better inform investors about how their money is being used.[46] Blass explained that:

> Our current requirements are not keeping up with changing market practices. Every few days I read another article about funds that have cut their fees and zero-fee funds. While real reductions in costs are good news for investors, I cannot help but ask a couple of questions:
>
> - First, are cuts in one place being made up in another?
> - Second, can an ordinary investor figure that out? Can an investor looking at the fee table answer my simple question – how much of my money is working for me?
>
> Transparency of fees and expenses is not the end of the story. If funds are relying on revenue sources not reflected in the fee table, does that implicate fund marketing rules? For example, under Rule 156 under the Securities Act a statement could be misleading in "the absence of explanations, qualifications, limitations or other statements necessary or appropriate to make [the] statement not misleading." With that in mind, are funds that advertise zero-fees, for example, considering whether explanations and qualifications are needed?[47]

In essence, Blass made clear that the Division of Investment Management's concentration on mutual fund fee and expense transparency has only heightened as the industry scrambles for profit solutions.

Similarly, Stephanie Avakian Co-Director of the SEC's Division of Enforcement, has said that the Division is "actively looking for circumstances where an adviser is financially conflicted by incentives that could affect investment recommendations to clients" and that "the more we look, the more undisclosed or inadequately disclosed financial conflicts we find."[48] Avakian urged,

> Advisers need to be proactive in evaluating potential conflicts of interest and assessing disclosures. This includes regularly assessing the compensation that they, their affiliates or their affiliated persons receive, and what decisions or recommendations they must make to their clients to receive that compensation.…Advisers need to be proactive in evaluating how changes to their business affect their disclosure obligations. They also need to take action once a conflict is identified.…This is an iterative process—as the market evolves or the business changes, you need to ask yourselves continually: are we being true to long-standing, fundamental principles, including full and fair disclosure?...We [at the SEC] of course do not know the full universe of potential problem areas. But…rest assured that we are looking. We will continue to allocate our resources towards making sure investors are fully informed when making their investment decisions.[49]

OCIE's articulated enforcement priorities for 2020 echo Blass's and Avakian's messages.[50] In the coming year OCIE reports that it will maintain its focus on the protection of senior and other retail investors, "including the various intermediaries that serve and interact with retail investors and the investments marketed to, or designed for, retail investors," with examinations in these areas honed in on "disclosures relating to fees, expenses, and conflicts of interest."[51] OCIE will continue its risk-based examinations of investment advisers, funds, and broker/dealers, with focus areas including the oversight practices of mutual fund and ETF boards.[52] In keeping with the Fiduciary Interpretation, OCIE will continue to assess advisers' fulfillment of their duties of care and loyalty. "This will include assessing, among other things, whether [advisers] provide advice in the best interests of their clients and eliminate, or at least expose through full and fair disclosure, all conflicts of interest which might incline an [adviser], consciously or unconsciously, to render advice which is not disinterested."[53]

OCIE also is bringing into the 2020s its "focus on risks associated with fees and expenses, and undisclosed, or inadequately disclosed, compensation arrangements…that may adversely impact portfolio management costs, reduce investor returns, and inappropriately influence investment decision-making;" it also will bring forward its prioritization of the examination of "financial incentives provided to financial services firms and professionals that may influence the selection of particular mutual fund share classes" and the "review for mutual fund fee discounts that should be provided to investors as a result of policies, contractual or disclosed breakpoints."[54] Once Reg BI and Form CRS become effective later in the year, OCIE "intends to assess implementation of the requirements of [Reg BI], including policies and procedures regarding conflicts disclosures, and for both broker-dealers and [advisers] the content and delivery of Form CRS."[55] And, lest there be any doubt, OCIE confirms that it has already integrated the Fiduciary Interpretation into its examination program.

## Conclusion

OCIE's priorities may provide some certainty about what lies ahead for fund share class and adviser compensation arrangements, but much remains unsettled. With the SEC's spotlight on revenue sharing practices, could we return to the era before Rule 12b-1 when many commenters believed that the proposed rule was too permissive and ill-advised because it inherently raised questions about how advisers calculated and used their profits?[56] Might so-called defensive Rule 12b-1 plans, prohibiting the use of fund assets for distribution costs but authorizing the adviser to use a portion of its management fees for distribution purposes, become an attractive solution? Will the typical Rule 12b-1 plan limit fees to 0.25 percent or less, or perhaps restrict the use of Rule 12b-1 fees to specific advertising costs? Should we look back to the SEC's failed 2010 Rule 12b-1 reform proposal for insight on what future SEC rulemaking might look like? Or will disclosure best practices, meeting the standards around client consent articulated in the Fiduciary Interpretation, develop and put the issue to rest?

The SEC has paid close attention to mutual fund distribution fees and adviser compensation arrangements for over 40 years, and its most recent enforcement activities and priorities confirm that it will continue to meticulously scrutinize the matter for the foreseeable future. This persistent eye of the regulator, combined with market trends, gives advisers and fund boards a seemingly strong incentive to avoid Rule 12b-1 share classes and revenue sharing arrangements altogether. But what will drive profitability? The relative ease by which the SEC Staff can identify share class related conflicts of interest and assert fiduciary duty violations, coupled with advisers' and funds' struggle to survive in a shrinking industry, makes this a compliance issue that adviser and mutual fund boards should be sure to discuss with counsel.

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Ahmadifar and Matthew S. Williams, "SEC Scrutiny of Advisers' Share Class Selection, Revenue Sharing and Disclosure Practices Continues Apace," Perkins Coie Update (Oct. 23, 2019).

## NOTES

1 *See, e.g.*, Gwendolyn A. Williamson, "Will 12b-1 Fees Cave Under Pressure? And Related Questions in a Time of Change," *The Investment Lawyer*, Vol. 25, No. 9 (Sept. 2018); *see also* 17 C.F.R. § 270.12b-1 (2019).

2 *Commission Interpretation Regarding Standard of Conduct for Investment Advisers*, Inv. Adv. Act Release No. 5248 (June 5, 2019). SEC Chairman Jay Clayton has defended the Fiduciary Interpretation, arguing, among other things that it is consistent with the US Supreme Court's decision in SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963), and merely reaffirms the existing fiduciary standard under the Investment Advisers Act of 1940. *See* Jay Clayton, Chairman, Securities & Exchange Commission, Remarks at the Stephen D. Cutler Center for Investments and Finance: *Regulation Best Interest and the Investment Adviser Fiduciary Duty—Two Strong Standards that Protect and Provide Choice for Main Street Investors*, Boston, MA (July 8, 2019), available at *https://www.sec.gov/news/speech/clayton-regulation-best-interest-investment-adviser-fiduciary-duty#_ftn1*.

3 *See, e.g.,* Gwendolyn A. Williamson, Thomas M. Ahmadifar and Matthew S. Williams, "Developments in the Regulation of Fiduciary Investment Advice," *The Review of Securities & Commodities Regulation*, Vol. 51 No. 18 (Oct. 24, 2018). Although outside the scope of this article, it should be noted that the debate over the protection of retirement and other retail shareholders is not isolated to the federal level. Several states are considering the adoption of their own fiduciary standards, albeit not without controversy. For instance, in Massachusetts, the Governor recently submitted a comment letter against the Secretary of the Commonwealth's 2019 fiduciary rule proposal. *See* Letter from Charles D. Baker, Gov. Mass., to William F. Galvin, Sec'y of Commonw. (Jan. 7, 2020), available at *https://www.sec.state.ma.us/sct/sctfiduciaryconductstandard/comments/2020-01-07-Governor-Charles-D.-Baker.pdf*.

4 Information in this article is current as of January 14, 2020.

5 Inv. Co. Act Release No. 11414 (Oct. 1980). Rule 12b-1 allows for fund assets to be used to cover distribution costs as long as they are paid pursuant to a distribution plan initially approved by fund shareholders and reviewed and approved at least annually by the fund board.

6 *See, e.g.* Inv. Co. Act Release No. 9470 (Oct. 1976). It was suggested at a 1976 SEC hearing that increased sales of mutual fund shares could benefit shareholders, making it appropriate under certain circumstances for fund shareholders to bear distribution costs at least under certain circumstances.

7 Inv. Co. Act Release No. 16431 (June 13, 1988).

8 *Id.*

9 Inv. Co. Act Release No. 16244 (Feb. 1, 1988).

10 Inv. Co. Act Release No 20614 (Oct. 13, 1994).

11 Inv. Co. Act Release No. 20915 (Feb. 23, 1995).

12 Inv. Co. Act Release No. 20916 (Feb. 23, 1995).

13 *See* Gwendolyn A. Williamson, "Tackling Mutual Fund Risks in the Omnibus Channel," *The Investment Lawyer*, Vol. 19, No. 7 (July 2012).

14 Letter from Douglas Scheidt, Associate Director and Chief Counsel, Division of Investment Management, Securities & Exchange Commission, to Craig S. Tyle, General Counsel, Investment Company Institute (Oct. 30, 1998).

15 *Id.*

16 Inv. Co. Act Release No. (July 21, 2010). The articulated goal of Rule 12b-2 was to ensure that individual shareholders paid only their proportionate share of a mutual fund's distribution-related costs, *i.e.* to "protect individual investors from paying disproportionate amounts of sales charges in certain share classes, promote investor understanding of fees, eliminate outdated requirements, provide a more appropriate role for fund directors, and allow greater competition

among funds and intermediaries in setting sales loads and distribution fees generally."

17 OCIE National Examination Program, "Examination Priorities for 2013" (Feb. 21, 2013), available at *https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2013.pdf*.

18 SEC IM Guidance Update No. 2016-01, "Mutual Fund Distribution and Sub-Accounting Fees," (Jan. 2016) available at *https://www.sec.gov/investment/im-guidance-2016-01.pdf*.

19 Many fund complexes began offering so-called clean shares, classes that did not impose any front-end load, deferred sales charge, or other asset-based fees (such as Rule 12b-1 fees) for sales or distribution. *See, e,g.,* Letter from Rachel Loko, Senior Counsel, Division of Investment Management, Securities & Exchange Commission, to the Capital Group (Jan, 11, 2017). *See also,* SEC, "Frequently Asked Questions on IM Guidance Update 2016-06 (Mutual Fund Fee Structures)," *www.sec.gov/divisions/investment/guidance/frequently-asked-questions-mutual-fund-fee-structures.htm*.

20 Conflicts of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. 20,946 (Apr. 8, 2016). *See also id.*, 81 Fed. Reg. 21,002, 81 Fed. Reg. 21,089, 81 Fed. Reg. 21,139, 81 Fed. Reg. 21,147, 81 Fed. Reg. 21,181, 81 Fed. Reg. 21,208 (Apr. 8, 2016).

21 OCIE National Examination Program, "OCIE's 2016 Share Class Initiative," (July 13, 2016), available at *https://www.sec.gov/files/ocie-risk-alert-2016-share-class-initiative.pdf*.

22 SEC Press Release, "SEC Office of Compliance Inspections and Examinations Announces 2018 Examination Priorities" (Feb. 7, 2018), available at *https://www.sec.gov/news/press-release/2018-12*.

23 SEC Press Release, "SEC Launches Share Class Selection Disclosure Initiative to Encourage Self Reporting and the Prompt Return of Funds to Investors" (Feb. 12, 2018), available at *https://www.sec.gov/news/press-release/2018-15*. *See also* SEC Announcement, "Share Class Selection Disclosure Initiative," available at *https://www.sec.gov/enforce/announcement/scsd-initiative*.

24 *See, e.g.* Inv. Adv. Act Rel. No. 5083 (Dec. 20, 2018); Inv. Adv. Act Rel. No. 5084 (Dec. 20, 2018); Inv. Adv. Act Rel. No. 5090 (Dec. 21, 2018).

25 SEC Press Release, "SEC Share Class Initiative Returning More Than $125 Million to Investors," (Sept. 30, 2019), available at *https://www.sec.gov/news/press-release/2019-200.*

26 SEC Press Release, "SEC Orders an Additional 16 Self-Reporting Advisory Firms to Pay Nearly $10 Million to Investors," (Mar. 11, 2019), available at *https://www.sec.gov/news/press-release/2019-28*.

27 Inv. Adv. Act Rel. No. 5387 (Sept. 30, 2019).

28 SEC Press Release, *supra* n.26.

29 In adopting Rule 12b-1, the SEC allowed that if a fund's management fee was not excessive within the meaning of Section 36(b) of the 1940 Act, the investment adviser was free to use its "legitimate profits" to cover fund distribution costs. Inv. Co. Act Release No. 11414 *supra* n.5.

30 While the activities at issue in the cases predate the Fiduciary Interpretation, the language used by SEC Staff echoes in many cases that of the Fiduciary Interpretation regarding advisers' obligation to provide investors disclosure enabling them to give informed consent to conflicts of interest.

31 SEC Press Release, "SEC Charges Investment Adviser for Failing to Disclose Conflicts Arising from Receiving Revenue Sharing On Client Investments," (Aug. 1, 2019), available at *https://www.sec.gov/litigation/litreleases/2019/lr24550.htm*.

32 The response was filed on September 30, 2019 in the US District Court for the District of Massachusetts (Case 1:19-cv-11655).

33 SEC Press Release, "SEC Charges Investment Adviser with Defrauding Its Advisory Clients," (Aug. 29, 2019), available at *https://www.sec.gov/litigation/litreleases/2019/lr24581.htm*.

34 SEC Press Release, "SEC Orders Investment Adviser to Pay $2.5 Million to Clients Related to Mutual Fund Share Class Selection Violations," (Sept. 29, 2019), available at *https://www.sec.gov/enforce/34-87029-s*.

[35] SEC Press Release, "Two BMO Advisory Firms Pay Over $37 Million to Harmed Clients for Failing to Disclose Conflicts of Interest," (Sept. 27, 2019), available at *https://www.sec.gov/news/press-release/2019-199*.

[36] SEC, "Frequently Asked Questions Regarding Disclosure of Certain Financial Conflicts Related to Investment Adviser Compensation," available at *https://www.sec.gov/investment/faq-disclosure-conflicts-investment-adviser-compensation*.

[37] *Id.*

[38] *Id.*

[39] *Regulation Best Interest: The Broker-Dealer Standard of Conduct*, Sec. Exch. Act Release No. 34-86031 (June 5, 2019) and *Form CRS Relationship Summary; Amendments to Form ADV,* Sec. Exch. Act Release No. 34-86032; Inv. Adv. Act Release No. 5247 (June 5, 2019). Reg BI and Form CRS were adopted by the SEC as part of the rulemaking package that included the Fiduciary Interpretation.

[40] Rule 6c-10 under the 1940 Act; Inv. Co. Act Rel. No. 33646 (Sept. 26, 2019). The articulated purpose of Rule 6c-10 is "to permit ETFs that satisfy certain conditions to operate without the expense and delay of obtaining an exemptive order from the [SEC] under the [1940] Act."

[41] *In the Matter of Precidian ETFs Trust, et al.*, (File No. 812-14405), Inv. Co. Act Rel. Nos. 33440 (Apr. 8, 2019) (notice) and 33477 (May 20, 2019 (order); the exemptive application is available at *https://www.sec.gov/Archives/edgar/data/1396289/000114420419018151/tv518160_40-appa.htm.*

[42] *See generally,* Investment Company Institute, "2019 Investment Company Factbook: A Review of Trends and Activity in the Investment Company Industry," available at *https://www.icifactbook.org*.

[43] *See, e.g.* Beagan Wilcox Volz, "Federated Cuts 12b-1 Fees on $8B in Bond Funds," *Ingites!* (Oct. 3, 2019).

[44] *See, e.g.* Andrew Welsh, "Ahead of Reg BI, UBS to Offer Single Mutual Fund Share Class in Brokerage," *OnWallStreet* (Nov. 5, 2019), and Emily Laermer, "UBS to Unveil Single-Share-Class Fund Structure Ahead of Reg BI," *Ingites!* (Nov. 7, 2019).

[45] Jeffrey Ptak, CFA, "Introducing the Enhanced Morningstar Analyst Rating for Funds" (Nov. 5, 2019), available at *https://www.morningstar.com/articles/953069/introducing-the-enhanced-morningstar-analyst-rating-for-funds.*

[46] Dalia Blass, Director of the Division of Investment Management, Securities & Exchange Commission, *Keynote Address — 2019 ICI Securities Law Developments Conference*, Washington, DC (Dec. 3, 2019), available at *https://www.sec.gov/news/speech/blass-keynote-address-2019-ici-securities-law-developments-conference*.

[47] *Id.*

[48] Stephanie Avakian, Co-Director of the Division of Enforcement, Securities & Exchange Commission, "What You Don't Know Can Hurt You," *Keynote Remarks at the 2019 SEC Regulation Outside the United States Conference*, London, England (Nov. 5, 2019), available at *https://www.sec.gov/news/speech/speech-avakian-2019-11-05*.

[49] *Id.*

[50] SEC Press Release, "SEC Office of Compliance Inspections and Examinations Announces 2020 Examination Priorities," (Jan. 7, 2020), available at *https://www.sec.gov/news/press-release/2020-4.*

[51] *Id.*

[52] *Id.*

[53] OCIE, "2020 Examination Priorities" (Jan. 7, 2020), available at *https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2020.pdf*.

[54] *Id.*

[55] *Id.*

[56] *See, e.g.* Inv. Co. Act Release No. 10862 (Sept. 1979).