Advisers Defend Fund Shares With Ongoing Fees

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By DAISY MAXEY

A proposal to limit some mutual-fund fees has advisers standing up for C shares, a fund share class that typically carries an ongoing charge that goes partly to advisers.

In letters to the Securities and Exchange Commission, the advisers say curtailing use of the shares would oblige advisers to charge some clients in other ways, and that this could hurt service or force advisers to simply drop some clients.

The SEC has proposed curbing mutual funds' 12b-1 fees, used to cover distribution and marketing costs. Class C shares typically charge a 12b-1 fee of 1% for as long as the investor owns the shares, and may have a back-end sales charge if sold within the first year. Class A shares, in contrast, are generally sold with a front-end sales load and often a 12b-1 fee of about 0.25%.

The SEC has proposed limiting the 12b-1 fee to 0.25% while permitting a front-end sales charge or ongoing sales charge. However, any fund carrying an ongoing charge must automatically convert to a share class without such a charge when the investor has paid about the amount they would otherwise have paid through a traditional front-end charge.

Curtailing C shares "will result in the need to wrap additional fees of up to 2% to clients for fee-based type of accounts," wrote Oren Peretz, an independent financial consultant with First Allied Securities Inc. in Encino, Calif. That will be too much for smaller clients, Peretz added in an interview.

Peretz says he has about 800 accounts with an average balance of $40,000. It's impossible to advise a client with a $10,000 balance for an ongoing commission of 0.25%, he said. "Ultimately, it will mean abandonment."

"It's easy to say I'm going to take a $25,000 account and wrap a fee around it, but at 2% or 2.5%, which would be exorbitant, it's not worth my time," he said.

Douglas Oakeson, a registered representative with Oakeson, Steiner & Lindsteadt in Hastings, Neb., said he manages about $250 million and earns about $850,000 to $900,000 in service fees through his broker/dealer LPL Financial Corp. That comes primarily via American Funds, which carry expense ratios of 80 basis points, Fidelity Advisor T shares, with expense ratios of 130 basis points, and Franklin C shares on bonds, with expense ratios of 110 basis points, Oakeson wrote the SEC. From that, his firm earns about 35 basis points on average, he said in an interview.

Limiting 12b-1 fees to 0.25% would cut the gross fees received on that business by $125,000, he said. "I would be forced to turn all accounts into advisory/fee based accounts," which would increase the all-in fee to clients to 1.5% on average, compared to 1% now, he said.

Lynn Appelman, a certified financial planner in Bloomsburg, Pa., said that, without an ongoing charge, advisers are less likely to provide ongoing service. "There is no financial incentive to service the client or provide other tax or estate-planning advice...," he wrote.

He fears some adviser might urge clients to make unnecessary changes in fund investments, just to get new fees and "maintain cash flow," he wrote.

Jeffrey Ball, a Red Bank, N.J.-based certified financial planner affiliated with RBC Wealth Management, wrote that "some advisors who use A shares recommend them based on their 10-year net cost, but often find a reason to sell and buy frequently. Those who sell C shares "have no incentive to churn accounts this way," Ball said.

Critics of C shares contend that 12b-1 fees have grown too large, aren't being used for the purposes originally intended and aren't transparent, making it hard for investors to calculate costs.

Daisy Maxey is a Dow Jones columnist who writes about investment products and independent broker-dealers. Her columns are available to Dow Jones Adviser subscribers.