

SEC Staff Allows Brokers to Set Commissions for Mutual Fund “Clean Shares”

April 10, 2017

On January 11, the SEC staff issued an interpretive letter to the Capital Group (CG Letter) stating that Section 22(d) of the Investment Company Act does not prevent brokers from charging commissions for effecting transactions in so-called “clean shares.” The CG Letter effectively allows brokers to compete on commission rates for the sale of mutual funds, as they do for ETFs, subject to certain conditions. The conditions of the CG Letter include:

- The clean shares must not include any form of distribution-related payments to the broker;
- The broker must represent in the relevant selling agreement that it is acting solely on an agency basis for the sale of clean shares;
- The clean shares prospectus must disclose (in the fee table) that brokers may charge a commission on the sale of the shares and, if applicable, that other share classes are available;
- Commissions collected by the broker must be consistent with FINRA rules and other applicable law; and
- Purchases and redemptions of clean shares must be made at net asset value.

SEC Staff Answers to Frequent Questions On February 15, the SEC staff published answers to certain questions regarding the CG Letter. For example, a fund with an institutional class would not be required to make a Rule 485(a) filing to add required clean shares disclosure. **Open Questions** The CG Letter clearly states clean shares may not be sold with sales loads or asset-based fees for sales or distribution. However, the CG Letter does not address whether a selling broker may receive service fees, such as sub-transfer agent or shareholder servicing fees, or revenue sharing payments from the fund’s adviser. In addition, some have wondered whether the legal premise of the CG Letter could be applied to the sale of variable insurance contracts. One potential issue to consider is that

brokers selling variable insurance contracts may be deemed to be acting as agents of the issuing life company.

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