

SEC Announces Self-Reporting Initiative for Rule 12b-1 Fee Disclosures

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Enforcement Division “Share Class Selection Disclosure Initiative” offers “favorable” settlement terms to advisers who self-report potential violations concerning Rule 12b-1 fees.

Background

Over the past several years, the Commission’s Office of Compliance Inspections and Examinations has placed an enhanced focus on identifying situations in which an adviser does not adequately disclose that it receives compensation for purchasing, or recommending a client purchase, mutual fund shares of a share class that pays fees under Rule 12b-1 when a less expensive share class is available and appropriate for the client.¹ The Enforcement Division has also brought a number of enforcement actions against advisers who are alleged to have inadequately disclosed that the adviser would select mutual fund share classes that benefited the adviser at the expense of the client.²

The Share Class Selection Disclosure Initiative

On February 12, 2018, the Enforcement Division announced a new initiative to redress “potential widespread violations” by encouraging advisers to self-report. Called the “Share Class Selection Disclosure Initiative” (the “SCSD Initiative”), the procedure offers advisers who self-report violations “favorable” standardized settlement terms. To participate in the initiative, an adviser must first notify the Enforcement Division that it intends to participate. Within ten business days of notification, the adviser must complete an SCSD Questionnaire and Attachment that discloses information including amount of 12b-1 fees that the adviser received “in excess of the lower-cost share class” for the period from January 1, 2014 “through the date the misconduct stopped,” and a “proposed amount of disgorgement.”

Advisers that self-report and are eligible will receive standardized settlement terms, including a “no admit, no deny” settlement, disgorgement of the excess fees and prejudgment interest, and the adviser’s acceptance of undertakings to correct the disclosure and/or policy and procedure failures that caused the violations. The Enforcement Division will recommend that the SEC not impose civil penalties on advisers that self-report and are eligible for the SCSD Initiative.

The SCSD Initiative announcement contains two notable warnings for advisers and their associated persons. *First*, the Enforcement Division “provides no assurance that individuals associated with these entities will be offered similar terms” if the individuals violated the securities laws. Accordingly, the

¹ SEC National Exam Program Risk Alert, OCIE’s 2016 Share Class Initiative (July 13, 2016), available at <https://www.sec.gov/ocie/announcement/ocie-risk-alert-2016-share-class-initiative.pdf>.

² See, e.g., *In the Matter of Packerland Brokerage Services, Inc.*, Investment Advisers Act Rel. No. 4832 (Dec. 21, 2017); *In the Matter of SunTrust Investment Services, Inc.*, Investment Advisers Act Rel. No. 4769 (Sept. 14, 2017); *In the Matter of Envoy Advisory, Inc.*, Investment Advisers Act Rel. No. 4764 (Sept. 8, 2017); *In the Matter of Cadaret, Grant & Co., Inc.*, Investment Advisers Act Rel. No. 4736 (Aug. 1, 2017); *In the Matter of Pekin Singer Strauss Asset Management Inc.*, Investment Advisers Act Rel. No. 4126 (June 23, 2015); *In the Matter of Manarin Investment Counsel, Ltd.*, Investment Advisers Act Rel. No. 3686 (Oct. 2, 2013).

Enforcement Division reserves the right to bring enforcement actions if the staff concludes that a particular person acted in a manner meriting individual liability. *Second*, the SCSD Initiative closes on June 12, 2018. The Enforcement Division warns that “enforcement actions outside of the SCSD Initiative will likely result in the staff recommending violations and remedies beyond those described in the Initiative, including penalties,” and that such penalties may be greater “than those imposed in past cases involving similar disclosure failures.” The message seems clear: the Enforcement Division wants to encourage advisers to self-report, and will seek to impose stiffer penalties on advisers who did not come forward during the SCSD Initiative.

The Commission has found success with adopting similar initiatives in the past, notably its 2014 through 2016 Municipalities Continuing Disclosure Cooperation (“MCDC”) Initiative. The MCDC Initiative sought to address “potentially widespread violations” of municipal underwriters’ continuing disclosure obligations under Exchange Act Rule 15c-12. The MDMC resulted in charges for 72 underwriters—representing 96% of the municipal underwriting market by volume. This initiative encouraged issuers and underwriters of municipal securities to self-report violations by similarly incentivizing parties with favorable settlement terms. Published settlements—and after the close of the SCSD Initiative, further enforcement actions—should indicate whether the SCSD Initiative receives a strong response and accomplishes the Commission’s goals. If the SCSD Initiative follows the success of the MCDC Initiative, the Enforcement Division may use it as a model to resolve other “potential widespread” violations through self-reporting and standardized settlement terms.

The SCSD Initiative also reflects the Commission’s continued commitment to retail investor protection and adequate fee disclosures, two of its priorities in recent years. Given the Commission’s prior success with outreach to issuers and underwriters of municipal securities, the SCSD Initiative leverages the Commission’s limited resources by placing strong incentives on advisers to self-report.

While the deadline to report is not until June 2018, advisers potentially eligible for the SCSD Initiative might consider reviewing disclosures and policies, and if any deficiencies are identified, proactively strengthening disclosures as well as programs and policies for the identification and disclosure of conflicts of interests. We would expect that noncompliance following the SCSD’s self-reporting period will come at an incrementally higher cost, and that retail investor protection will remain a focus for the Commission.

- ▶ [See a copy of the Announcement](#)
- ▶ [See a copy of the SCSD Initiative Questionnaire](#)
- ▶ [See a copy of the SCSD Initiative Attachment to Questionnaire](#)

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