The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

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SEC Division of Investment Management Issues Interpretive Letter under Section 22(d) of the Investment Company Act of 1940

[30518] January 12, 2017 TO: ICI Members
Investment Company Directors
ICI Global Members
Investment Advisers Committee
Pension Committee
SEC Rules Committee
Small Funds Committee SUBJECTS: Disclosure
Distribution
Fees and Expenses
Fund Governance
Intermediary Oversight
Investment Advisers RE: SEC Division of Investment Management Issues Interpretive Letter under Section 22(d) of the Investment Company Act of 1940

The SEC Division of Investment Management has issued an interpretive letter under section 22(d) of the Investment Company Act of 1940 ("1940 Act") with respect to the distribution of fund shares.[1] In the letter, the staff expresses its view that, under the circumstances described in the letter, the restrictions of section 22(d) of the 1940 Act do not apply to a broker, when the broker acts as agent on behalf of its customers and charges its customers commissions for effecting transactions in a class of fund shares without any front-end load, deferred sales charge, or other asset-based fee for sales or distribution ("Clean Shares"). The staff also states its belief that section 22(d) does not prohibit a principal underwriter of Clean Shares from entering into a selling agreement with a broker under the circumstances described in the letter. The staff issued its interpretive letter in response to an incoming letter[2] requesting narrowly-tailored interpretive guidance to address issues raised under the Department of Labor's fiduciary rule ("DOL Rule"). The staff's letter is summarized briefly below.

Background

Section 22(d) of the 1940 Act, often referred to as the retail price maintenance rule, prohibits a mutual fund, the fund's principal underwriter, and dealers in the fund's shares from selling the fund's shares at a price other than a current public offering price described in the fund's prospectus. The letter explains that, while section 22(d) does not apply to brokers, there is uncertainty about the application of section 22(d), and many firms are

unsure whether charging a commission for effecting transactions in Clean Shares could cause them to be treated as dealers under section 22(d).

Interpretation of Section 22(d)

The staff's letter confirms that the restrictions of section 22(d) do not apply to a broker when the broker acts as agent on behalf of its customers and charges its customers commissions for effecting transactions in Clean Shares. In taking this position, the staff reiterates the following representations from the incoming letter:

- The broker will represent in its selling agreement with the fund's underwriter that it is acting solely on an agency basis for the sale of Clean Shares;
- The Clean Shares sold by the broker will not include any form of distribution-related payment to the broker;
- The fund's prospectus will disclose that an investor transacting in Clean Shares may be required to pay a commission to a broker, and if applicable, that shares of the fund are available in other share classes that have different fees and expenses;
- The nature and amount of the commissions and the times at which they would be collected would be determined by the broker consistent with the broker's obligations under applicable law, including but not limited to applicable FINRA and DOL rules; and
- Purchases and redemptions of Clean Shares will be made at net asset value established by the fund (before imposition of a commission).

The SEC staff notes that this letter does not address the effect under section 22(d) of a broker receiving revenue sharing payments from the fund's adviser. The staff also clarifies that its position does not depend on whether a broker sells Clean Shares to investors in retirement accounts or nonretirement accounts.

Sarah A. Bessin
Associate General Counsel

Linda French
Counsel

endnotes

[1] SEC Interpretive Letter (pub. avail. Jan. 11, 2107), available at https://www.sec.gov/divisions/investment/noaction/2017/capital-group-011117-22d.htm.

[2] *Available at* https://www.sec.gov/divisions/investment/noaction/2017/capital-group-011117-22d-incoming.pdf. The incoming letter notes that the DOL Rule was designed to mitigate conflicts of interest in the provision of investment advice to retirement plan participants, including individual retirement account investors. The DOL Rule suggests that one way to address a particular conflict of interest for brokers recommending funds to their retirement account investors is for brokers to equalize their compensation across all of the funds they recommend. An "externalized" fee structure for funds, i.e., where brokers would charge their customers commissions for effecting transactions in Clean Shares, is one approach to address such conflicts of interest.