

MEMO# 30687

May 9, 2017

Operational Considerations for New Share Classes in Response to the Department of Labor Fiduciary Rule

[30687]

May 9, 2017 TO: ICI Members

Bank, Trust and Retirement Advisory Committee

Broker/Dealer Advisory Committee

Operations Committee

Pension Committee

Pension Operations Advisory Committee

Sales and Marketing Committee

Small Funds Committee

Transfer Agent Advisory Committee SUBJECTS: Distribution

Operations

Pension

Recordkeeping

Transfer Agency RE: Operational Considerations for New Share Classes in Response to the Department of Labor Fiduciary Rule

Introduction and background

On April 6, 2016, the Department of Labor (DOL) issued a final regulation (final rule) defining who is a “fiduciary” under Section 3(21) of the Employee Retirement Income Security Act of 1974 and Section 4975(e)(3) of the Internal Revenue Code as a result of giving investment advice to an employee benefit plan, plan fiduciary, plan participant or beneficiary, individual retirement account (IRA), or IRA owner. As the DOL notes, the final rule treats persons who provide investment advice or recommendations for a fee or other compensation with respect to assets of a plan or IRA as fiduciaries in a wider array of advice relationships. On April 5, 2017, the DOL finalized a 60-day delay to the applicability date of the final rule, extending the applicability date from April 10, 2017 to June 9, 2017.[\[1\]](#)

The final rule requires consideration of a number of complex legal, business, and operational issues that each market participant must take into account as it decides how best to implement rule-compliant policies and practices. Each market participant independently evaluates such issues and considerations in the context of its own business as it determines its own course of action. This memorandum identifies and discusses some

of the legal and operational considerations relevant to possible product structures firms may have under consideration as options to facilitate compliance with the final rule. ICI expresses no view as to the policies, practices, or product structures or other options a firm may consider, which depend on each market participant's individual circumstances and business objectives.

Since April 2016, ICI Operations worked with members and their intermediary partners on the operational considerations of implementing the final rule, including options that involve new or evolving product structures.[\[2\]](#) A review of recent share class filings with the SEC indicates two distinct share class "types" under consideration. The share classes and their general characteristics as reflected in these filings are described below.[\[3\]](#)

- Clean shares are offered without front-end or deferred sales charges or other asset-based fees for sales or distribution. Based on a recent SEC staff interpretive letter issued under section 22(d) of the Investment Company Act of 1940, a broker, acting solely as agent on behalf of its customers, may charge commissions on transactions in clean shares without being subject to the restrictions of section 22(d).[\[4\]](#)
- T shares have a streamlined front-end sales charge schedule with fewer tiers and a narrower band of applicable sales charge percentages than a traditional front-end sales charge share class (e.g., Class A). This share class typically limits the use of universal sales charge discounts.[\[5\]](#)

Implementation considerations

As with all share class launches, intermediaries selling shares of a particular class must ensure that they do so consistent with the fund's disclosures in its prospectus and SAI, including applicable disclosures regarding sales charges, and the availability of breakpoint discounts, letters/statements of intent, and rights of accumulation.[\[6\]](#) Broker-dealers also must comply with applicable FINRA rules regarding sales of mutual fund shares and breakpoint discounts.[\[7\]](#) There are some unique nuances to both clean and T shares with regard to their operational rollout and ongoing administration. To that end, the following topics have been identified through ICI's implementation work with members and intermediaries as potentially important operational considerations for both product types.

Clean shares and T shares

- In connection with implementation of the final rule, intermediaries may consider moving existing investors into new share classes. Member policies vary regarding class to class conversions, including eligibility, fund notification requirements, management of outstanding deferred sales charge obligations, and support of scheduled versus on-demand conversions. Members should consider clarifying their class conversion policies with intermediaries as soon as practicable, so any transitions potentially affecting existing investors can be effectively managed.[\[8\]](#)
- Members should consider reviewing with intermediaries their options for how to apply "traditional" retail sales charge discounts such as rights of accumulation and letters/statements of intent within the entire fund complex, including the treatment of clean and T share assets.[\[9\]](#)
- Members should ensure that the disclosure in their prospectuses and SAs regarding sales charges, and any available discounts such as rights of accumulation and letters/statements of intent, is accurate with respect to existing and new share classes or is revised, if necessary.

Clean shares

- While the transaction-based commission model described in the SEC staff interpretive letter is common for many products offered by intermediaries, it is not common for mutual funds, and therefore may raise operational considerations. Therefore, members that are launching clean shares may wish to discuss with intermediary partners the plans and timing for clean share rollout, including the operational impacts of any extended transition period to clean shares.
- Some members may repurpose one or more existing share classes as clean shares, often through updated SEC filings to incorporate appropriate eligibility and disclosure. As a result, clean shares are not readily identifiable by a common alpha-numeric identifier (e.g., A shares) to guide systems and other operational behaviors. Operationally, the absence of sales charges and asset-based distribution fees will become important identifiers for clean share classes.

T shares

- Members should consider clarifying for intermediaries how daily transaction activity should be evaluated when applying the sales charge, including the role of daily trade aggregation within accounts.
- Members should consider confirming with intermediaries whether mutual fund exchange transactions^[10] are permitted, or if separate sale and purchase transactions must be used to move shareholders between funds in T shares to ensure correct application of sales charge.

With the applicability date for the final rule quickly approaching, members should consider approaching their intermediary partners to discuss product implementation rollout plans and expectations, and their operational impact, as soon as possible. Clarity during the implementation process should help contribute to a successful operational launch of these products.

Please direct any questions to the undersigned (jeff.naylor@ici.org or 202-326-5844).

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endnotes

^[1] See ICI Memorandum No. [30667](#), dated April 6, 2017. For a description of the fiduciary rule and exemptions, see ICI Memorandum No. [29837](#), dated April 13, 2016.

^[2] The ICI's DOL Fiduciary Duty Rule Implementation Resource Center features [Operational Implementation](#) resources covering compliance considerations relevant to product structure, investor communications, disclosures, and other back-office operational topics.

^[3] Specific fund prospectuses and statements of additional information (SAIs) should always be consulted for applicable characteristics, which may vary.

^[4] For more about the SEC staff interpretive letter, see ICI Memorandum No. [30518](#) dated

January 12, 2017.

[5] Universal sales charge discounts are made available to all eligible shareholders, as described in the fund's prospectus or SAI. For instance, ICI's review of T share filings indicate that T shares typically permit reinvestments of dividends and capital gains at Net Asset Value (NAV). Conversely, sales charge discounts for customers of specific intermediaries also may be supported. For more about disclosing scheduled variations for intermediaries, see SEC IM Guidance Update, Issue [2016-06](#), December 2016.

[6] *Disclosure of Breakpoints by Mutual Funds*, 69 Fed. Reg. 33262 (June 14, 2004) (SEC release adopting amendments to Form N-1A requiring enhanced fund disclosure of breakpoint discounts).

[7] FINRA Rules 2341 and 2342. See also NASD Special Notice to Members 02-85(Dec. 2002), available at <http://www.finra.org/sites/default/files/NoticeDocument/p003029.pdf>.

[8] In some instances, members could require amendments to contractual agreements with intermediaries prior to use of a share class.

[9] Broker-dealers also must comply with applicable FINRA rules. See *supra* note 7.

[10] A mutual fund exchange is a single transaction on fund transfer agent or brokerage subaccounting systems used to sell shares from one fund with proceeds used to purchase shares of another fund within the same fund family. By default, most systems apply traditional front-end load fund prospectus rules to exchanges—an exchange purchase occurs at NAV if the shares sold by the exchange have previously been assessed the same (or a higher) sales charge percentage. If the fund's T share prospectus requires a sales charge to be assessed on each T share purchase transaction, exchange purchases at NAV would not be permissible.