

MEMO# 34881

February 6, 2023

IM Staff Issues Guidance on Differential Advisory Fee Waivers

[34881]

TO: ICI Members

Investment Company Directors SUBJECTS:

Compliance

Disclosure

Fees and Expenses

RE: IM Staff Issues Guidance on Differential Advisory Fee Waivers

The staff of the SEC's Division of Investment Management recently issued a reminder to mutual funds and their boards that fee waiver and expense reimbursement arrangements that are long-term or permanent (or effectively long-term or permanent) and that result in different advisory fees being charged to different share classes of the same fund ("differential advisory fee waivers") may result in cross-subsidization between classes and may be prohibited.[\[1\]](#)

The guidance notes that advisory fees charged to shareholders of all mutual fund classes should generally be the same percentage amount, as shareholders of the same mutual fund should receive the same advisory services no matter what class they are invested in.[\[2\]](#) It highlights previous Commission statements that waivers and reimbursements were not intended to become "de facto modifications of the fees provided for in advisory or other contracts so as to provide a means for cross-subsidization between classes" and the concern that such cross-subsidization could lead to prohibited inequitable or discriminatory provisions among classes.[\[3\]](#)

In the staff's view, whether a differential advisory fee waiver presents a prohibited cross-subsidization is a facts-and-circumstances determination that a mutual fund's board (in consultation with the investment adviser and its counsel) should consider making and documenting after considering all relevant factors.[\[4\]](#)

The staff suggests that a board consider whether existing differential advisory fee waivers present a means for cross-subsidization, whether the steps the fund is taking to monitor such waivers are effective, and/or whether alternative fee arrangements may be appropriate. It also suggests that funds consider the extent to which the board's consideration of these issues should be disclosed.

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Notes

[1] See SEC Division of Investment Management, Differential Advisory Fee Waivers (Feb. 2, 2023), available at <https://www.sec.gov/investment/differential-advisory-fee-waivers>.

[2] Many mutual funds rely on Rule 18f-3 under the Investment Company Act of 1940 to operate as multi-class funds. The rule provides relief to open-end funds from Section 18(f)(1) and 18(i) of the Investment Company Act, which are broadly intended to restrict funds from issuing securities containing inequitable or discriminatory provisions. Section 18(f)(1) of the Investment Company Act generally makes it unlawful for an open-end fund to issue any class of senior security that has priority over another class as to distribution of assets or payment of dividends. Section 18(i) of the Investment Company Act requires that every share of stock that a registered investment company issues be voting stock, with the same voting rights as every other outstanding voting stock.

[3] See Exemption for Open-End Management Investment Companies Issuing Multiple Share Classes; Disclosure by Multiple Class and Master-Feeder Funds; Class Voting on Distribution Plans, Investment Company Act Rel. No. 20915 (Feb. 23, 1995), 60 Fed. Reg. 11876, 11879 and note 30 (Mar. 2, 1995), available at <https://www.govinfo.gov/content/pkg/FR-1995-03-02/pdf/95-4997.pdf>.

[4] For example, the staff notes that a board could determine that a differential advisory fee waiver arrangement is appropriate if it finds: (1) that shareholders in a waived class pay fees to the adviser at the investing fund level in a funds-of-funds structure; and (2) that such fees, when added to the advisory fees that are paid by the waived class, after giving effect to the waiver, are at least equal to the amount of advisory fees paid by the other classes, such that the waiver is demonstrably not being subsidized by the other classes.