Fund industry limits C-share investing, cutting 12b-1 fee income for advisers

Growing pressure on fees and disclosures drives wave of C-share conversions to A-share funds

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The great share-class migration that has been building this year is starting to unfold, representing a significant pay cut for advisers relying on beefy 12b-1 fees for predictable income streams.

Over the next few months, several fund companies plan to start converting C-class share mutual funds that have been held between seven and 10 years into A-class shares that pay advisers smaller 12b-1 fees.

"I don't know what the main catalyst is for these conversions, but I think there are multiple reasons," said Niels Holch, executive director of the Coalition for Mutual Fund Investors. "I'm not surprised that C shares are becoming somewhat antiquated — there has been criticism for a number of years about how C shares work and collect a fee in perpetuity."

For advisers, the difference between collecting a 1% 12b-1 fee on a C share and a 25 basis point fee on the same fund converted to an A share translates to real money.

For example, an adviser with $5 million in client assets invested in C-share funds would be collecting $50,000 a year in 12b-1 fees, compared to $12,500 from an A-share version.

Most of the fund companies scheduling conversions are mum on the moves beyond regulatory filings and announcements to brokerage firms. But the conversions are scheduled to start happening across the fund industry at such firms as BlackRock, **Fidelity Investments**, Franklin Templeton, Morgan Stanley and **Putnam Investments**.

Some industry watchers are tracing the share-class migration to a **February Securities and Exchange Commission initiative** that announced it would waive fines against advisers who came forward and confessed to having put clients in high-fee mutual fund classes and agreed to reimburse those clients.

"The liability is being exposed and people are starting to realize they were sold the wrong share class," said James Langston, president of Fiduciary Integrity.

The current share-class migration relates specifically to **C shares that have higher 12b-1 fees** but not upfront loads, and load-waived A-share versions of the same mutual fund.

In most cases, **the break-even point** when it makes more sense to pay the upfront load of up to 5.5% on an A share versus paying the higher 12b-1 fee of a C share is about seven years.

At American Funds, for example, most **C-share funds convert automatically into A shares** after seven years.

But other fund companies are now moving to introduce conversion policies to both help advisers toe the line with regulators and keep those assets from leaving the fund complex.

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While the current conversions are only designed to limit how long an investor can be parked in a particular C-share class fund, **the road ahead could get even rockier**.

"There's a lot of pressure on advisers these days to be upfront about high-fund fees and disclosing compensation arrangements," said Karen Wallace, senior editor at Morningstar.com. "C shares are going away because they are a bad deal for investors. B shares were a similarly bad deal and they are pretty much, if not completely, extinct."