

SEC to consider banning trailer fees

Protecting retail investors should be regulator's top priority, Shapiro says

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By James Langton

The head of the U.S. Securities and Exchange Commission says that retail investors should be the SEC's top priority, that it will focus on improving point-of-sale disclosure, and will rethink whether trailer fees should be permitted.

Speaking to the Consumer Federation of America's 21st annual Financial Services Conference, SEC chairman, Mary Schapiro, said that retail investors are the constituency that the SEC should "be most attuned".

"After all, broker-dealers and investment advisers put lots of thought and energy into selling their products and services to the public. They figure out how they can get new investors in the door and how they can make a profit. So, I want to be sure that we — at the SEC — are putting just as much thought and energy into how to protect individuals who are entrusting their money to our capital markets," she said.

"I want to know that we've thought through what investors encounter when they walk into a financial professional's office or call them on the phone. For example: Does the investor make a distinction between brokers and investment advisers, the way the law does? Does the investor get the relevant, simple and comparable information at the point of sale or recommendation, or only after the sale has occurred, if at all? Does the investor know about all the fees they are being charged and whether they are getting the services they are being charged for? And, does the investor appreciate the nuances of retirement investments and products?" she said.

To address these concerns, the SEC is considering a variety of reforms. For one, it is planning to hold both broker-dealers and investment advisers to the same standard of care, imposing a fiduciary duty on them. "I believe that all securities professionals should be subject to the same fiduciary duty — and that all investors receiving advice should rest assured that the advice they get is being given with their interest at heart," she said.

Additionally, she said that both types of firms should be subject to the same level of oversight. "This approach may disrupt a number of entrenched interests. But, we are doing no service to retail investors by continuing with a distinctly different regulatory approach for professionals who perform virtually the same or similar services," she stressed.

Point-of-sale disclosure must also be improved, she said. "I believe retail investors should be provided clear, simple, meaningful disclosure at the time they are making an investment decision — disclosure that includes comprehensible and comparable information about the securities products and services being offered. It also should include information about the compensation the professional will receive on each product being sold — and information about the conflicts that may be causing the advisor or salesman to steer the investor to a certain investment," she noted.

Schapiro admitted that this will not be easy, and that the financial industry will resist, but she stressed that it's necessary. "Based on past experience, I know that getting to the point where we can have meaningful point of sale disclosure will be difficult. There will likely be significant pushback from the industry related to cost and convenience. But anything worth doing is not easy," she said.

Related to the question of upfront disclosure, is the issue of trailer fees, or 12b-1 fees, as they are known in the U.S. "The problem is that our investor may have no idea these fees are being deducted or who they are ultimately compensating. That's why I believe there needs to be a better approach," she said.

"When it comes to these fees, there is a need for more fundamental change than merely disclosure reforms and a name change. We must critically rethink how 12b-1 fees are used and whether they continue to be appropriate," she said. "For example, do they result in investors overpaying for services or paying for distribution services that they may not even know they are supposed to be getting?"

These fees amounted to more than \$13 billion in 2008, up from just a few million dollars in 1980 when they were first permitted, she reported. "Of course, in 1980, they may have made sense — but after 30 years of growth and change in the mutual fund market, it is past the time to reassess their need and their effectiveness," she said, adding that she has asked SEC staff for a recommendation on 12b-1 fees for the commission to consider in 2010.

Finally, she said that more effort needs to be applied to improving investor education and financial literacy. In particular, she has also asked SEC staff to provide the commission with its recommendations on target date funds early next year, noting that recent market losses have undermined the promise of these funds for investors near retirement.

"The 'set it and forget it' slogans of these funds resulted in shocked investors who were on the verge of retirement. It was a wake-up call for investors, employers and regulators, alike," she said "Our staff has been focused on the marketing materials related to these funds and the use of target dates in fund names. I believe this an area in need of reform for the benefit of America's retirement investors, and I look forward to completing the work we have started."

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