

More Fund Companies Sanctioned for Misusing Fund Assets for Distribution

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The SEC recently settled enforcement actions against William Blair and two Calvert companies for using mutual fund assets to pay distribution-related expenses in violation of Investment Company Act Rule 12b-1 and for certain other misconduct. The cases follow a similar 2015 enforcement action against First Eagle, the first casualty of the SEC's "distribution-in-guise" sweep, and the SEC staff's January 2016 Guidance Update on Mutual Fund Distribution and Sub-Accounting Fees. Although the improper payments in these cases were made to broker-dealer firms, similar violations could result from mutual fund assets being paid to other intermediaries, including insurance companies whose separate accounts invest in the fund. Regardless of the nature of the intermediary, Rule 12b-1 prohibits the use of fund assets to pay directly or indirectly for distribution except pursuant to a board-approved, written 12b-1 plan. In the two recent cases, fund assets were used to make payments under certain agreements that the fund companies, apparently through administrative error, considered to be for "sub-transfer agency" services. In fact, the agreements clearly included the provision of distribution and marketing services although no 12b-1 plan was applicable. The two cases thus, like First Eagle, spotlight obvious violations of Rule 12b-1, but shine little light on harder questions where it may be unclear whether a portion of sub-accounting or similar fees are being used to pay directly or indirectly for distribution, one of the many issues raised in the staff's 2016 guidance. Also of interest is that William Blair misspent \$1.25 million of fund assets and was fined \$4.5 million, while Calvert misspent nearly \$18 million but was fined only \$1 million. In both cases the SEC acknowledged that the fund companies took prompt remedial actions (including making the funds whole), but only in Calvert did the SEC acknowledge self-reporting of the improper fee payments and significant cooperation with the SEC's investigation by the fund companies, which "assisted the [SEC] staff in efficiently investigating the conduct."

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