



Best Practices in Share Class Reviews

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The following is a list of best practices applicable to the share class review process. This guide aims to provide helpful tips regarding the process of replacing an advisory client's existing mutual fund share class with a lower cost alternative, where it is identified that a replacement option exists and may be available for placement in the client's account at the custodian.

- 1. Review of share classes on periodic basis.** Engage in share class reviews on a periodic basis, generally no less than every six months. Available share classes are subject to change at the fund and custodian level – a less expensive share class may later become available. Integrate the review and record retention procedures into your compliance manual and compliance calendar. In addition, institute a process for the review, and if required, conversion, of share classes held by new accounts, including any legacy or inherited mutual fund account assets. Procedures for the execution and documentation of this process should be also integrated into your compliance manual and compliance calendar.
- 2. Obtain conversion status for any replacements.** Make every effort to ensure that any share class replacements take place as conversions or exchanges from the existing share class to the new. This should avoid creating a taxable event for non-qualified accounts and the cost basis should transfer or remain. This is different than a buy/sell transaction or a rebalance, both of which may create a taxable event for the client. Take great care to coordinate with your custodian(s) prior to and during the conversion process, and make sure any trade instructions specify a conversion in writing. While this method is a common industry practice, it should not be assumed that the custodian will do this automatically.

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If conversion is not available, generally the replacement would have to be made by a buy/sell or swap trade. The creation of a tax liability for an operational or business-oriented transaction could be less than desirable for a client. However, a potential tax liability doesn't automatically negate the need for a replacement. The burden of proof is on the firm as to whether delaying or foregoing the trade for tax purposes would be a greater benefit to the client than the cost savings associated with the lower cost share class over the holding period. This can be a grey area, as holdings may have different tax statuses for different clients (i.e. short-term gain for newer clients, long-term gain for others), or fluctuate from a gain to a loss from market volatility during the holding period.

3. Watch out for transaction fees. Custodians and platforms may impose ticket fees for trading mutual funds. These may apply to buys, sells, or exchanges. It is always best to check with your custodian or platform provider well in advance of any planned replacements. Similar to the potential tax liability scenario described above, the avoidance of a transaction fee on behalf of a client does not excuse the obligation to obtain the lowest cost share class—and the burden of evidence will be on the firm. A cost-benefit analysis would need to be completed showing that trading costs would outweigh the expense ratio savings over the entirety of the anticipated holding period.

4. Rank and seek Alternate Share Class (ASC) candidates by lowest cost. Firms that are fiduciaries are required to do what is in the best interest of their clients. For best execution of mutual funds, you have a duty-of-care obligation to seek the lowest cost investment option available to each client. Some funds may have more than one ASC. ASC candidates should be ranked by their cost, with the lowest cost option being pursued first, and then, if necessary, continuing in that order.

5. Diligently pursue replacement candidates.

Where an ASC has been identified as a potential candidate to replace the client's existing holding, the replacement should be pursued by all means possible until all avenues and efforts have been fully exhausted. This means even if the replacement fund carries a transaction fee, is soft-closed for trading at the custodian, or the existing holding's market value is below the ASC's prospectus or custodial minimum, generally speaking, the replacement should still be pursued. In a case where a holding has multiple ASCs, you should exhaust all efforts on the lowest cost (first-ranked) option before moving on to the next.

6. Seek waivers where minimums aren't met. On its own, a stated prospectus minimum is not a valid reason to avoid making a replacement in the eyes of the SEC. Fund minimums are known to be "soft." Firms must seek waivers on behalf of their clients for potential ASC candidates. The process of seeking a waiver involves contacting the investment company/fund issuer and asking them to waive the minimum. They will often ask for information such as the amount of exposure your firm and/or client(s) have to the fund, how frequently you trade, where the assets are located (i.e. your custodian/platform), whether they trade omnibus, what share class you are converting to and from, etc. You should be prepared to cooperate by providing this information to the investment company.

7. Use omnibus trading to meet higher minimums. Many platforms trade omnibus with fund companies. That means they may be able to meet the fund minimums by the aggregated purchases across their book of business, or at the least your firms. This can help in meeting the larger minimums imposed by some ASCs, possibly making them accessible without having to get a waiver. Check with your custodian and/or platform provider beforehand to find out if they operate on an omnibus basis.

8. **Document EVERYTHING.** Make sure you have a plan in place to capture and retain records and correspondence pertaining to your efforts for each ASC candidate, whether or not it succeeds as a replacement. The SEC will want proof that the share class that your client is holding was indeed the lowest cost option that could be obtained. In the case of waivers, even if you are 100% sure the investment company or custodian/platform is going to say “No,” it is best practice to request the waiver. All correspondence pertaining to waiver requests of minimums and/or other prospectus limitations should be kept in the share class review file. It is best to obtain an email response or other written correspondence from the fund or platform. In some instances, companies may not be willing to provide a response in writing. In these cases, a file memo documenting the request including, date, time, person, title, summary of the conversation, and end result should be made and kept in the file.
9. **Make it a team effort.** As early in the process as possible, the firm should identify the team members in compliance, operations, trading, etc. who will be involved in the process and create a plan to get everyone abreast of the mission and tasks at hand. Share class reviews and the ensuing replacement process can span multiple layers and reach across many levels of the firm. It will likely take more than one or two people to do the job correctly and completely.

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