SEC wraps up B share fraud case

By Bruce Kelly **InvestmentNews**

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NEW YORK - Putting an end to a B share saga, the Securities and Exchange Commission last week said that an independent-contractor registered representative who was with an ING Advisors Network Inc. broker-dealer in the late 1990s committed fraud when he sold mutual fund B shares.

At the same time, the commission dismissed charges of a failure to supervise that it had brought against the rep's firm and its former president.

The SEC said that William Kissinger, formerly with IFG Network Securities Inc. - which now is part of another ING broker-dealer, Denver-based Multi-Financial Securities Corp. - committed fraud when he "negligently omitted to disclose material facts" to six clients about the cost structures of various classes of mutual funds, including B shares.

The fracas ended last Tuesday when the SEC ordered Mr. Kissinger to "cease and desist" from any other violations and to pay a disgorgement of $36,710.

The SEC and NASD of Washington have been hammering broker-dealers and registered reps recently with cases involving B shares, industry attorneys noted.

Those cases often hinge on the lack of investor suitability when buying B shares, which is much easier to prove than fraud, attorneys said.

In March 2005, the SEC and NASD hit a handful of broker-dealers - with various business models - with enforcement actions that totaled more than $41 million in fines and customer restitution.

"This case is pretty typical of what the regulators are alleging in other B shares cases," said Terry Lister, chief regulatory officer of Waddell & Reed Inc. of Overland Park, Kan.

Mr. Lister said that the SEC outlined in its opinion the four basic points which regulators want firms and their reps to keep in mind when selling mutual fund B shares. First, in this case, A shares were likely to produce higher returns than B shares for investors at the amounts at which they bought B shares, according to the SEC. Second, investors got break-point discounts when they purchased A shares, as applicable - in this instance, at the $250,000 and $500,000 levels.

Third, B shares' higher 12(b)-1 fees increased the expense ratio by 0.75 percentage points, according to the SEC. And finally, Mr. Kissinger received a larger commission for the sale of the B shares than he would have if the six clients purchased A shares instead, the SEC said.

Mutual fund class B shares usually have a deferred sales charge, or back-end load, unlike class A shares, which have an initial sales charge, or load. Mutual fund A shares also include break-point discounts, which reduce the front-end load when investors' assets in the fund reach specific amounts.

Dating back to Mr. Kissinger's sales of mutual fund B shares between 1998 and 2001, the IFG case had a number of twists and turns.

The SEC in 2003 originally had five targets in the case: three reps - including Mr. Kissinger - IFG and its former president, David Ledbetter.

The commission claimed that the brokers had committed fraud by not disclosing that investments of $250,000 or more would have produced materially higher returns in A shares than in B shares.

Last year, an administrative law judge dismissed the SEC's case. The SEC administrative law judge, Carol Fox Foelak, kicked a hole in the commission's argument, saying, "In sum, it is unproven that A shares always outperform B shares at the $250,000 level."

The SEC last March then appealed that dismissal, but only in part, dropping allegations against the two other reps from IFG, which was based in Atlanta.

Mutual fund B shares were a small portion of Mr. Kissinger's book of business, according to the SEC's opinion in the case.

"In 2000, investments in Class B shares of mutual funds represented approximately 11% of the $300 million that [Mr.] Kissinger had under management," the SEC said.

"We are pleased with the commission's decision, and we are pleased that this matter is resolved," said Dana Ripley, a spokesman for ING Advisors Network in Atlanta.

Based in Hunt Valley, Md., Mr. Kissinger moved his practice in 2001 to Sanders Morris Harris Inc. of Houston. He opened his firm, Kissinger Financial Services, in 1984.

Focus on negligence

Mr. Kissinger's attorney, Matt Siembieda, a partner with Blank Rome LLP of Philadelphia, along with other industry lawyers, stressed that the SEC's opinion focused on the broker's negligence.

Mr. Siembieda also noted that Mr. Kissinger was following common practices of the industry at the time of the B share sales.

"There certainly was no prohibition on selling these things at the time," he said.