

MEMO# 20905

February 28, 2007

State of Washington Fines Fund Distributor For Violations of the Washington Securities Act Involving Bulk Exchanges

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TO: COMPLIANCE MEMBERS No. 11-07
BROKER/DEALER ADVISORY COMMITTEE No. 15-07
SEC RULES MEMBERS No. 25-07
SMALL FUNDS MEMBERS No. 18-07
SALES FORCE MARKETING COMMITTEE No. 4-07 RE: STATE OF WASHINGTON FINES FUND
DISTRIBUTOR FOR VIOLATIONS OF THE WASHINGTON SECURITIES ACT INVOLVING BULK
EXCHANGES

The State of Washington has announced its settlement of a matter in which a mutual fund distributor was found to have violated the antifraud provisions of the Securities Act of Washington in connection with bulk exchange agreements with certain financial intermediaries. [\[1\]](#) In settling this matter, the distributor agreed to: cease and desist from further violations of the antifraud provision; terminate its bulk exchange agreements; pay \$394,500 in restitution to impacted mutual funds and a fine to the State of \$100,000; and reimburse the State \$175,000 for expenses incurred in its investigation. The findings in this matter are summarized below.

According to the Consent Order entered in this matter, the distributor entered into Telephone Exchange Agreements ("TEAs") with a number of financial intermediaries. The TEA firms were permitted to submit mutual fund exchange requests on behalf of their clients in bulk regardless of whether the firm was the broker of record on the account. Non-

TEA firms could not place bulk exchange requests for client accounts directly with the distributor unless the firm was the broker of record on the account. Under the TEAs, firms could exchange up to 400% of their assets under management each year, but were required to comply with exchange limitations in the funds' prospectuses and other limitations on when the exchange orders had to be placed. The distributor reserved the right to delay certain large exchange requests (i.e., those involving more than 100 accounts or \$500,000 in one fund, or \$1 million in a combination of funds) for up to five business days if, in the distributor's judgment, the exchanges would be disruptive to the funds involved. The distributor created a Bulk Exchange Desk to receive, execute, and monitor all bulk exchanges.

According to the Consent Order, from 2000-2003, the TEA firms' bulk exchange activity resulted in negative dilution in nine of the thirteen funds involved. The Consent Order further finds that, during this period, the distributor failed to (1) maintain adequate records, (2) appropriately monitor the bulk exchange activity of the TEA firms, and (3) disclose the existence of the TEAs in the funds' prospectuses, SAs, and other documents distributed in Washington. The Consent Order concludes that this conduct violated the antifraud provision in the Washington Securities Act.

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endnotes

[1] See *In re OppenheimerFunds Distributor, Inc.*, Order No. S-04-012-07-CO01 (Feb. 23, 2007) (the "Consent Order"), which is available on the website of the Washington Department of Financial Institutions at:
<http://www.dfi.wa.gov/sd/orders/s-04-012-07-co01.pdf>.