INVESTMENT COMPANY INSTITUTE

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July 3, 2007

NASD Fines Four Firms for Mutual Fund Sales Violations

[21332]

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TO: COMPLIANCE MEMBERS No. 33-07
SEC RULES MEMBERS No. 79-07
SMALL FUNDS MEMBERS No. 53-07
BROKER/DEALER ADVISORY COMMITTEE No. 30-07 RE: NASD FINES FOUR FIRMS FOR MUTUAL FUND SALES VIOLATIONS

NASD settled charges against four member firms involving mutual fund sales violations, including improper Class B and Class C share sales and failure to implement net asset value (“NAV”) transfer programs. [1] In settling the matter, the firms neither admitted nor denied the findings.

Improper Sale of Class B and Class C Shares

According to the settlement documents, three of the firms had suitability, supervisory and compliance policies and procedures that were inadequate to achieve compliance with NASD rules related to Class B and/or Class C share mutual fund sales. In particular, NASD found that the firms’ suitability, supervisory and compliance policies and procedures were not reasonably established, maintained and/or enforced to ensure that the firms, at the point of each sale, provided consideration to, on a consistent basis, the benefits of the various mutual fund share classes as they applied to individual clients. For example, the firms’ procedures did not set forth a means to adequately identify purchases of Class B and/or Class C shares by customers for whom Class A shares would have been more economically beneficial. The firms’ written policies and procedures did not require their registered representatives to weigh the economic consequences to a customer of purchasing different share classes or to explain those consequences to customers. In addition, the firms’ procedures were not sufficient to ensure that their registered representatives made adequate disclosure to each client about the various classes of mutual funds.

Failures Relating to Mutual Fund Sales Charge Waivers

According to the settlement documents, two of the firms did not provide certain investors the opportunity to purchase Class A shares of certain mutual funds through available NAV transfer programs. In particular, certain mutual funds offered NAV transfer programs that allowed investors to purchase Class A shares at NAV and not pay any sales charges, if the customer invested proceeds from the redemption of shares of a fund of another mutual fund family within specified time frames and previously had paid either a front-end or back-end sales charge. NASD found that, during the relevant period, the firms failed to establish, maintain and enforce a supervisory system and procedures reasonably designed to identify opportunities for clients to purchase mutual funds at NAV and ensure that clients received the benefit of available NAV transfer programs when appropriate. Specifically, the firms failed to review adequately whether fund families offered NAV transfer programs either before entering into selling agreements or after signing selling agreements with the mutual fund families; had no system to periodically review the funds to determine if an NAV transfer program was offered at any specific time; failed to identify certain qualifying programs; and, failed to identify certain customers who qualified for such pricing.

Based on the alleged conduct, NASD found that the four firms violated NASD Conduct Rules 2110, 2310 and 3010. They were censured, and NASD ordered remediation plans for each of the firms, according to their particular violations. The three firms found to have improperly sold Class B and/or Class C shares were also fined for those violations. In settling the charges against the two firms for failures relating to NAV transfer programs, NASD did not impose a fine against one of the firms and imposed a reduced fine against the other firm. Such measures were taken in recognition of proactive remedial actions by one firm taken prior to NASD's detection of the conduct and prompt remedial actions by the other firm taken after an NASD examination identified the violative conduct. NASD stated in its press release that it hoped its decision to exercise restraint in imposing fines would "encourage other firms to increase their efforts to proactively identify compliance problems, promptly assess and correct underlying supervisory deficiencies and timely compensate any customers harmed."

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endnotes

[1] *See* "NASD Settles Cases Against MML Investors Services, NYLIFE Securities, Securities America and Northwestern Mutual Investment Services for Fines Totaling over $1.2 Million for Failures Relating to Mutual Fund Sales," NASD Press Release (June 28, 2007), available at http://www.nasd.com/PressRoom/NewsReleases/2007NewsReleases/NASDW_019355.