

MEMO# 25320

July 11, 2011

FINRA Fines Broker-Dealer for Failure to Timely Provide Mutual Fund Shareholders With Prospectuses

[25320]

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TO: BANK, TRUST AND RECORDKEEPER ADVISORY COMMITTEE No. 40-11
BROKER/DEALER ADVISORY COMMITTEE No. 42-11
COMPLIANCE MEMBERS No. 30-11
TRANSFER AGENT ADVISORY COMMITTEE No. 53-11 RE: FINRA FINES BROKER-DEALER FOR FAILURE TO TIMELY PROVIDE MUTUAL FUND SHAREHOLDERS WITH PROSPECTUSES

FINRA recently fined a retail distributor of mutual fund shares (the “broker-dealer”) \$1 million for its failure to timely deliver prospectuses to approximately 934,000 customers who purchased mutual funds in 2009. [\[1\]](#) According to FINRA’s AWC, which is attached, this conduct was in contravention of Section 5(b)(2) of the Securities Act of 1933, and thereby violated FINRA Rule 2010. FINRA’s findings, as set forth in the AWC, are briefly described below.

As noted in the AWC, Section 5(b)(2) of the Securities Act of 1933 prohibits the delivery of securities unless accompanied by or preceded by a physical copy of a prospectus. Pursuant to SEC Rule 10b-10 under the Securities Exchange Act of 1934, such prospectus must be delivered to the customer by the settlement date, which is no later than three business days after the transaction. According to the AWC, approximately 934, 000 customers of the broker-dealer received their prospectuses from one to 153 days late. In particular, 47% prospectuses were delivered within three days of settlement, 69 % within seven days of settlement, and 94% within 14 days of settlement. The AWC finds that the primary cause of the late deliveries was the failure of certain mutual fund companies to maintain adequate supplies of paper copies of prospectuses. “As a result, for many purchases from these fund companies, neither the service provider nor [the broker-dealer] could obtain a prospectus to timely provide to the customer. [The broker-dealer] did not take steps to change the practices of those fund companies that did not keep adequate stocks of prospectuses either prior to, or during, the Relevant period.” [\[2\]](#) The AWC also finds that the broker-dealer had notice that its customers were not receiving prospectuses on a timely basis due to regular reports it received from the service provider it had retained to fulfill its delivery obligations.

The AWC notes that this was the third time the broker-dealer had been sanctioned for failing to make required deliveries to customers. In April 2009, the firm was fined \$1.4 million and required to comply with certain undertakings for failing to deliver prospectuses and product descriptions to customers who purchased nine different investment products between July 1, 2003 and December 31, 2004. In February 2009, the firm and its affiliate were censured and fined \$1.1 million and required to comply with certain undertakings for failing to have policies and procedures in place to mail approximately 800,000 required notifications to customers in violation of the Securities Exchange Act and related NASD rules.

In addition to the fine, the broker-dealer was censured and it undertook, within 120 days of FINRA's acceptance of the AWC, to adopt and implement systems and procedures reasonably designed to achieve compliance with the federal securities laws and FINRA rules.

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[Attachment](#)

endnotes

[1] See Re: Wells Fargo Advisors, LLC, FINRA Letter of Acceptance, Waiver, and Consent No. 20100229218 (March 21, 2011) (the "AWC"). The AWC also finds that, from July 1, 2008 through June 30, 2009, the broker-dealer filed 147 late amendments to Forms U4, relating to customer complaints, arbitrations, civil litigation, regulatory matters, and bankruptcies. This amounted to 8.1% of the 1,808 amendments the broker-dealer was required to file during this period.; It also filed 40 late amendments to Forms U5, which represented 7.6% of the 522 Form U5 amendments it was required to file.

[2] AWC a p. 5. The AWC notes that the broker-dealer did not take remedial steps available to it to ensure that its customers were receiving prospectuses in a timely fashion. For example, the broker-dealer did not utilize its vendor's "print on demand" feature, which would have ensured an adequate supply of prospectuses for deliver.

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