

MEMO# 28193

June 18, 2014

FINRA Sanctions Broker-Dealer for Failing to Waive Sales Charges in Accordance with Mutual Fund Prospectuses

[28193]

June 18, 2014

TO: COMPLIANCE MEMBERS No. 11-14

OPERATIONS MEMBERS No. 5-14

SEC RULES MEMBERS No. 23-14

BROKER/DEALER ADVISORY COMMITTEE No. 33-14

BANK, TRUST AND RETIREMENT ADVISORY COMMITTEE No. 26-14

TRANSFER AGENT ADVISORY COMMITTEE No. 35-14

SALES FORCE MARKETING COMMITTEE No. 6-14

PRINCIPAL UNDERWRITERS WORKING GROUP RE: FINRA SANCTIONS BROKER-DEALER FOR FAILING TO WAIVE SALES CHARGES IN ACCORDANCE WITH MUTUAL FUND PROSPECTUSES

FINRA has sanctioned a broker-dealer “for failing to waive mutual fund sales charges for certain charities and retirement accounts” between 2006 and 2011. [\[1\]](#) The sanctions imposed by FINRA include a censure, a fine of \$8 million, and restitution to shareholders of approximately \$24.4 million. [\[2\]](#) The facts underlying these sanctions are briefly described below.

According to the AWC, in 2006, the broker-dealer learned that, contrary to the mutual funds’ prospectus disclosure regarding the availability of sales charge waivers, the broker-dealer had failed to apply such waivers to certain retirement plan accounts and charitable organizations that purchased mutual fund shares through its retail platform. The AWC finds that, after becoming aware of this problem, the broker-dealer (1) continued to sell shares through December 2011 without correcting the problem [\[3\]](#) and (2) failed to notify its sales force, customers, and regulators of the problem. Indeed, the AWC finds that, through the broker-dealer formed a cross-disciplinary task force in 2006 “to evaluate and recommend solutions” for certain accounts impacted by the error, development of a system to address the concerns identified by the task force “commenced in 2008, almost two full years after the Firm’s discovery of this problem, but was never fully funded or implemented.” As stated in the AWC:

[The broker-dealer] determined that the cost of changing its operating system to facilitate these waivers would be prohibitive. [The broker-dealer] asked each mutual fund family that offered such a waiver to consider limiting the waiver so that it would not apply to the purchases effected through brokerage firms, thus relieving the Firm from administering the sales waivers. Six of the twelve fund families eliminated the 501(c)(3) waivers and five revised their prospectus language to require 501(c)(3) entities to purchase the funds directly from the fund company in order to receive the sales waivers. One fund family refused to limit the availability of the sales waiver, and as a result, [the broker-dealer] stopped selling shares of that fund family on its retail platform. [4]

Based on these findings, FINRA found that the broker-dealer violated FINRA Rule 2010 and NASD 2110 by failing to identify and apply sales charge waivers to eligible retirement accounts and charitable organizations. [5] FINRA also found that the broker-dealer violated FINRA Rule 3010 relating to supervision. As summarized in the AWC:

[The broker-dealer] failed to establish and maintain an adequate supervisory system and written procedures to identify Class A mutual fund sales charge waivers in fund prospectuses, failed to adequately notify and train its financial advisors regarding mutual fund sales waiver eligibility requirements, and failed to have an adequate supervisory system to ensure that eligible accounts purchased Class A shares with sales charge waivers. [6]

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endnotes

[1] See In Re Merrill Lynch, Pierce, Fenner & Smith, FINRA Letter of Acceptance, Waiver and Consent (No. 2011029999301), dated June 16, 2014 (the “AWC”), which is available at: <http://disciplinaryactions.finra.org/viewdocument.aspx?DocNB=36381>.

[2] In total, this restitution is expected to be paid to over 16,000 accounts involving 17 mutual fund families. AWC at p. 11. This restitution is in addition to the \$64.8 million the broker-dealer has voluntarily paid in remediation to certain retirement plans and charitable organizations affected by this issue. AWC at p. 3.

[3] The AWC notes that the firm “self-reported the issue to FINRA in January 2011.” AWC at p. 7.

[4] AWC at fn. 14.

[5] FINRA Rule 2010 governs standards of commercial honor and principles of trade. It requires each FINRA member to observe high standards of commercial honor and just and equitable principles of trade. In 2008, FINRA Rule 2010 replaced NASD Rule 2110, which had imposed a similar requirement on broker-dealers. Because the broker-dealer’s conduct spanned 2006-2011, it was found to have violated both FINRA Rule 2010 and NASD Rule 2110. AWC at fn. 4.

[\[6\]](#) AWC at p. 10.

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