

MEMO# 4712

April 20, 1993

SEC STAFF LETTER ON DISCLAIMERS OF LIABILITY FOR TELEPHONE TRANSACTIONS

April 20, 1993 TO: SEC RULES MEMBERS NO. 37-93 OPERATIONS MEMBERS NO. 20-93
TRANSFER AGENT ADVISORY COMMITTEE NO. 28-93 RE: SEC STAFF LETTER ON
DISCLAIMERS OF LIABILITY FOR TELEPHONE TRANSACTIONS

As you know, the Division of Investment Management has been reviewing the disclosure required to be included in a fund prospectus if the fund disclaims liability for acting upon instructions for telephone exchanges or redemptions. In January 1992, the staff advised registrants that a fund including a disclaimer of liability in its prospectus must also include a clear description of the fund's policy with respect to losses resulting from fraudulent telephone transactions and state that as a result of the fund's policy the investor will bear the risk of loss in the event of a fraudulent telephone transaction. In addition, a statement that the staff of the SEC is currently reviewing the propriety of such a policy was required to be included in the fund prospectus. Yesterday, the Division of Investment Management advised the Institute as to its position on the propriety of disclaimers of liability for telephone transactions. In a letter to the Institute, the Division stated that it now believes "it is misleading for a fund to attempt to disclaim all liability for losses resulting from unauthorized or fraudulent telephone transactions regardless of the precautions the fund takes to avoid such losses." While the Division does not believe that funds are, or should be, strictly liable for losses due to unauthorized telephone transactions, the letter states that funds "are responsible for exercising reasonable care to prevent such transactions." The Division's letter states that a mutual fund that offers investors the ability to engage in telephone transactions may advise investors that it will not be liable for following instructions communicated by telephone that it reasonably believes to be genuine. Regardless of whether or not a fund includes such a statement in its prospectus, it must include the following information in its prospectus and in any other document describing telephone transactions: 1. a statement as to whether the privilege to initiate transactions by telephone will be made available to shareholders automatically or whether the shareholder must first elect the privilege; 2. a statement to the effect that the fund will employ reasonable procedures to confirm that instructions communicated by telephone are genuine, and that if it does not, it may be liable for any losses due to unauthorized or fraudulent instructions; and 3. a description of the procedures the fund follows for transactions initiated by telephone (e.g., requiring a form of personal identification prior to acting upon instructions received by telephone, providing written confirmation of such transactions, recording telephone instructions). As a matter of policy, the staff did not take a position with respect to the adequacy of procedures adopted by funds to protect shareholders against loss. However, the staff commended the mutual fund

industry for developing certain procedures, in conjunction with ICI Mutual Insurance Company, to limit losses due to fraudulent telephone transactions. A fund should include the foregoing disclosure in its prospectus at the next possible opportunity but no later than when it files the post-effective amendment updating its financial statements pursuant to section 10(a)(3) of the Securities Act. The Division will not object if a fund files this post-effective amendment pursuant to rule 485(b) if otherwise qualified to do so. * * * A copy of the Division of Investment Management's letter to the Institute is attached. Patricia Louie Associate Counsel Attachment

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