

**MEMO# 19454**

December 19, 2005

# **MUTUAL FUND COMPLEX REACHES SETTLEMENTS WITH SEC, NASD, AND STATE OF MINNESOTA REGARDING MARKET TIMING AND SALES PRACTICES**

©2005 Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice. [19454] December 19, 2005 TO: BOARD OF GOVERNORS No. 68-05 CHIEF COMPLIANCE OFFICER COMMITTEE No. 69-05 COMPLIANCE MEMBERS No. 30-05 SEC RULES MEMBERS No. 130-05 SMALL FUNDS MEMBERS No. 104-05 RE: MUTUAL FUND COMPLEX REACHES SETTLEMENTS WITH SEC, NASD, AND STATE OF MINNESOTA REGARDING MARKET TIMING AND SALES PRACTICES The Securities and Exchange Commission has issued orders making findings and imposing disgorgement, monetary penalties, and remedial sanctions in enforcement actions against a registered investment adviser to a group of mutual funds ("Funds") and its affiliated broker-dealer (together "Respondents").<sup>1</sup> The SEC action against the adviser involves allegations that it acted contrary to prospectus disclosures when it allowed certain shareholders to market time the Funds when the Funds' prospectus disclosures expressly prohibited market timing. The SEC action against the broker-dealer involves allegations that it failed to adequately disclose certain material facts to its brokerage customers in the offer and sale of mutual fund shares and interests in college savings plans established under Section 529 of the Internal Revenue Code ("529 plans"). The Respondents consented to the entry of the SEC Orders without admitting or denying the SEC's findings. NASD also announced the settlement of charges relating to the broker-dealer's receipt of directed brokerage in return for providing preferential treatment to certain mutual fund companies.<sup>2</sup> In settling with NASD, the broker-dealer consented to the entry of NASD's findings without admitting or denying the allegations. Finally, the Minnesota Department of 1 See In the Matter of American Express Financial Corporation (now known as Ameriprise Financial, Inc.), SEC Release Nos. IA-2451 and IC-27170 (Dec. 1, 2005); In the Matter of American Express Financial Advisors Inc. (now known as Ameriprise Financial Services, Inc.), SEC Release Nos. 33-8637 and 34-52861 (Dec. 1, 2005) ("SEC Orders). The SEC Orders also censure and impose cease and desist orders against the Respondents. Copies of the SEC Orders are available on the SEC's website at <http://www.sec.gov/litigation/admin/ia-2451.pdf> and <http://www.sec.gov/litigation/admin/33-8637.pdf>, respectively. 2 See NASD Fines Ameriprise Financial Services \$12.3 Million for Directed Brokerage Violations (press release issued by NASD, Dec. 1, 2005), available at [http://www.nasd.com/web/idcplg?IdcService=SS\\_GET\\_PAGE&ssDocName=NASDW\\_015638&ssSourceNodId=1](http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_015638&ssSourceNodId=1) 346. A copy of the NASD Letter of Acceptance, Waiver and Consent is

attached. 2 Commerce announced a settlement with the Respondents of related state charges.<sup>3</sup> The four actions are summarized below.

**I. SEC Order Against Adviser A. Findings** The SEC Order finds that in January 2002, the adviser changed the prospectus disclosures for the Funds to specifically prohibit market timing. Despite this express prohibition, the adviser still permitted certain market timers to continue market timing the Funds for an additional six to eight months. The SEC Order further states that from May 2002 to October 2003, the adviser allowed a known market timer to continue to market time variable annuity products sold by the adviser contrary to the products' prospectus disclosure. According to the SEC Order, the adviser did not put in place any procedures to monitor or prevent employees of the adviser and related companies from market timing the Funds through their 401(k) accounts or disclose to investors that there were no such procedures until October 2003. Based upon the conduct generally described above, the SEC found that the adviser willfully violated the antifraud provisions of Section 206(2) of the Investment Advisers Act of 1940 and Section 34(b) of the Investment Company Act of 1940.

**B. Undertakings** In settling this matter, the adviser agreed to the comply with the following undertakings:

- **Yearly Board Presentations:** The adviser will make annual presentations to its boards of directors and the Funds' boards of directors about the adequacy of its policies and procedures on market timing.
- **Independent Distribution Consultant:** Within 60 days of the entry of the SEC Order, the adviser will retain an Independent Distribution Consultant not unacceptable to the SEC staff. The adviser will submit to the consultant and the SEC staff within 120 days after the entry of the SEC Order a plan to distribute the total disgorgement and penalties ordered. Following the issuance of an SEC order approving a final plan of disgorgement, the consultant and the adviser will take all necessary and appropriate steps to administer the final plan.

**C. Sanctions** The adviser must pay \$15 million in disgorgement and civil penalties.

<sup>3</sup>See *Company Corrects Mutual Fund Sales Practices, Pay \$2 million Penalty to Minnesota* (press release issued by Minnesota Commerce Commissioner Glenn Wilson, Dec. 1, 2005), available at <http://www.state.mn.us/portal/mn/jsp/common/content/include/contentitem.jsp?contentid=536908404>.

**3 II. SEC Order Against Broker-Dealer A. Findings** The SEC Order finds that between January 2001 and August 2004, the broker-dealer did not adequately disclose material information concerning its conflicts of interest in offering and selling shares of 27 preferred mutual fund families whose affiliates made revenue sharing payments to the adviser in exchange for, among other things, inclusion on the broker-dealer's brokerage platform. Although between April 2003 and August 2004 the broker-dealer's disclosures concerning these conflicts improved, the SEC Order states that such disclosures were still deficient in certain respects. The SEC Order also alleges that from October 2003 to the present, the broker-dealer failed to disclose similar information concerning revenue sharing payments made to the broker-dealer by affiliates of nine fund families that administered 529 plans offered by the broker-dealer. Based upon the conduct generally described above, the SEC found that the broker-dealer willfully violated (i) the antifraud provisions of Section 17(a)(2) of the Securities Act of 1933 and Section 15B(c)(1) of the Securities Exchange Act of 1934 and (ii) the confirmation requirements of Rule 10b-10 under the Exchange Act and Rule G-15 under the Municipal Securities Rulemaking Board.

**B. Undertakings** In settling this matter, the broker-dealer agreed to the following undertakings:

- **Public Website Disclosure:** The broker-dealer will place and maintain on its public website disclosures concerning revenue sharing payments it receives from certain mutual fund families, including revenue sharing payments received for sales of 529 plans. The broker-dealer also will send this information to its current customers and to new customers upon opening of an account.
- **Yearly Board Presentation:** At least once a year, the broker-dealer will make presentations to its board of directors, including an overview of its revenue sharing arrangements (including amounts) and the adequacy of its policies and procedures on revenue sharing.
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Independent Distribution Consultant: Within 60 days of the entry of the SEC Order, the broker-dealer will retain an Independent Distribution Consultant not unacceptable to the SEC staff. The broker-dealer will submit to the consultant and the SEC staff within 120 days after the entry of the SEC Order a plan to distribute the total disgorgement and penalties ordered. Following the issuance of an SEC order approving a final plan of disgorgement, the consultant and the broker-dealer will take all necessary and appropriate steps to administer the final plan. C. Sanctions The broker-dealer must pay \$30 million in disgorgement and civil penalties. 4 III. NASD Action A. Findings NASD found that from January 2001 through December 2003, the broker-dealer maintained two shelf space (or revenue sharing) programs in which participating mutual fund complexes paid a fee in return for preferential treatment by the broker-dealer. That treatment included enhanced access to the broker-dealer's sales force and the posting of participant sales materials and information on the broker-dealer's internal website. Seven of the fund complexes paid their fees for participating in the programs by directing approximately \$41 million in mutual fund portfolio brokerage commissions to the broker-dealer. NASD contends that those payments violated NASD Conduct Rules 2830(k) and 2110. B. Sanctions The broker-dealer was censured and fined \$12.3 million. IV. State of Minnesota Action The Minnesota Department of Commerce alleges that the Respondents violated Minnesota securities laws by: • Allowing inappropriate market timing to occur by failing to have written policies and procedures and failing to properly supervise its employees; • Failing to establish and enforce policies and procedures that would ensure that the most appropriate mutual fund share class was recommended to its customers; • Failing to establish and maintain supervisory systems to ensure compliance with suitability obligations relating to the sale of 529 plans; and • Failing to observe high standards and equitable principles. In settling these allegations, the Respondents have agreed to pay a \$2 million civil penalty and to complete a compliance review of its sales practices and its written procedures regarding market timing, revenue sharing, 529 plans, and Class B mutual fund sales practices. The report is due in one year and will include a summary of actions taken to ensure compliance with applicable laws and regulations and certification by a senior officer regarding its compliance and supervisory procedures. Jane G. Heinrichs Associate Counsel Attachment 5 Note: Not all recipients receive the attachment. To obtain a copy of the attachment, please visit our members website (<http://members.ici.org>) and search for memo 19454, or call the ICI Library at (202) 326-8304 and request the attachment for memo 19454. Attachment (in .pdf format)