

MEMO# 18423

January 18, 2005

BROKER-DEALER SETTLES NASD CHARGES RELATING TO MARKET TIMING OF MUTUAL FUNDS

[18423] January 18, 2005 TO: CHIEF COMPLIANCE OFFICER COMMITTEE No. 3-05 COMPLIANCE ADVISORY COMMITTEE No. 4-05 SEC RULES MEMBERS No. 10-05 SMALL FUNDS MEMBERS No. 5-05 RE: BROKER-DEALER SETTLES NASD CHARGES RELATING TO MARKET TIMING OF MUTUAL FUNDS The NASD has announced the settlement of charges against a registered broker-dealer for enabling a hedge fund customer to engage in deceptive market timing of mutual funds.* In settling the matter, the broker-dealer neither admitted nor denied the NASD's allegations or findings. The settlement, which is attached, is briefly described below. According to the NASD, the broker-dealer permitted two of its registered representatives to establish customized accounts for clients intending to trade mutual funds "in an aggressive manner," despite knowing that certain mutual funds available to those clients discouraged or limited such trading. The NASD found that shortly after the accounts commenced trading, various fund families began to notify the broker-dealer of improper market timing transactions and to impose restrictions on (or ask that the broker-dealer restrict) further timing activity. It further found that the broker-dealer, acting through the representatives and their branch manager, assisted one client in evading such restrictions by trading through related accounts and opening two additional accounts for the client. The NASD determined that the broker-dealer failed to: (1) have appropriate systems and procedures in place to detect and prevent improper market timing; and (2) adequately respond on a timely basis to "red flags" that would have alerted it to the representatives' efforts to evade fund trading restrictions. The broker-dealer agreed to a censure, payment of a \$500,000 fine, and restitution of \$325,000 to the affected mutual funds. It further agreed to certify to the NASD, within 30 days of the settlement, that it has reviewed its procedures regarding market timing and has * See NASD Fines H&R Block Financial Advisors \$500,000 for Enabling Deceptive Market Timing, Orders Payment of \$325,000 in Restitution (press release issued by NASD, Dec. 21, 2004), available at http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_012819&ssSourceNodId=5 51. The press release states that the NASD's investigation into the activities of particular individuals involved in this market timing scheme is continuing. 2 established systems and procedures reasonably designed to: (1) achieve compliance with applicable laws concerning market timing; and (2) ensure that fund prospectus exchange limits and provisions of selling agreements are enforced. Rachel H. Graham Assistant Counsel Attachment 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 18423, or call the ICI Library at (202) 326-8304 and request the attachment for memo 18423. Attachment (in .pdf format)

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