

MEMO# 5692

March 18, 1994

NASD REMINDS MEMBERS OF SALES PRACTICE OBLIGATIONS

March 18, 1994 TO: COMPLIANCE COMMITTEE NO. 6-94 SEC RULES MEMBERS NO. 14-94 SUBCOMMITTEE ON ADVERTISING NO. 6-94 RE: NASD REMINDS MEMBERS OF SALES PRACTICE OBLIGATIONS _____ The NASD recently published the attached Notice to remind its members of their obligations to ensure that investments in mutual funds are suitable for their customers and to disclose and discuss certain matters in the sale of mutual funds. 1. Disclosure. The Notice reminds members of the need to disclose all material facts to customers and the effect of any sales charges on the anticipated return. The NASD believes that merely determining that an investment is suitable for a particular investor does not excuse members from their disclosure obligations. Members are also reminded that oral representations by sales personnel that contradict the disclosures in the prospectus or sales literature may nullify the effect of the written disclosure and members may be liable for rule violations and civil damages to customers as a result. 2. Breakpoints. The Notice also provides that members must affirmatively disclose the existence of any "breakpoints" in order to enable customers to evaluate the desirability of making a qualifying purchase. Delivery of a "breakpoint letter" to a customer advising the customer of the possibility of breakpoint savings is not a safe harbor for compliance with their obligations to their customers. 3. Switching. The Notice also reminds members that they have an obligation to evaluate the net investment advantage of any recommended switch from one fund to another and that switching from one fund to another may be difficult to justify if the financial gain or desired result is undermined by transactions fees incurred with the switch. If recommendations are made to fund investors to engage in market timing, then such transactions should be within a single family of funds or where there are virtually no transaction costs associated with the trade. 4. SIPC Coverage. The Notice cautions members against stating or implying that SIPC provides insurance against loss of a customer's investment or that SIPC is the equivalent of the FDIC or a guarantor of the value of a security in the manner that the U.S. Government is for Treasury securities. It states that any representations to the contrary may result in disciplinary action. 5. Suitability. The Notice states that members selling funds to elderly, retired or first-time investors must have an adequate and reasonable basis for the sale. 6. Internal Controls. The Notice also states that members "must develop appropriate internal controls, supervisory and compliance, to ensure that all mutual fund sales practices comply with all relevant NASD rules, and are consistent with high standards of commercial honor and just and equitable principles of trade." The Notice emphasizes that supervision of compliance with written procedures is crucial since failure to enforce established procedures is the same as having no procedures at all. 7. Advertising/Marketing. The Notice reminds members acting as underwriters to ensure that all advertising and marketing materials have been filed and approved. It also cautions members against making or

permitting changes to the material in the prospectus or other approved material if the effect would be to "exaggerate, obscure, or minimize material information." Patricia Louie
Associate Counsel Attachment

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