MEMO# 18935

June 10, 2005

NASD SETTLES WITH 15 BROKER-DEALERS RELATING TO DIRECTED BROKERAGE VIOLATIONS

 [18935] June 10, 2005 TO: BROKER/DEALER ADVISORY COMMITTEE No. 22-05 BROKER/DEALER ASSOCIATE MEMBERS No. 10-05 CHIEF COMPLIANCE OFFICER COMMITTEE No. 47-05 COMPLIANCE MEMBERS No. 4-05 SEC RULES MEMBERS No. 78-05 SMALL FUNDS MEMBERS No. 56-05 RE: NASD SETTLES WITH 15 BROKER-DEALERS RELATING TO DIRECTED BROKERAGE VIOLATIONS The NASD has announced the settlement of charges against 15 broker-dealers in connection with the receipt of directed brokerage in exchange for preferential treatment for certain mutual fund companies.* The cases focused on 14 retail brokerage firms and one mutual fund distributor. In settling each of these matters, the broker-dealers neither admitted nor denied the NASD's allegations or findings. The NASD found that 14 retail broker-dealers operated "preferred partner" or "shelf space" programs that provided certain benefits to a relatively small number of mutual fund complexes in return for directed brokerage. The benefits to mutual fund complexes of these arrangements, included higher visibility on the broker-dealer firms' internal websites, increased access to the firms' sales forces, participation in "top producer" or training meetings, and promotion of their funds on a broader basis than was available for other funds. The mutual fund complexes that participated in these programs paid extra fees for enhanced visibility, which were typically based on a combination of sales and/or assets under management at the brokerage firm. Some of the mutual fund complexes participating in the programs paid part or all of the revenue sharing fees by directing a portion of the trades in the portfolios they managed to the trading desks of the firm participating in the program. The broker-dealers generally monitored the amount of directed brokerage received to ensure that the fund complexes were satisfying their revenue sharing obligations. The NASD also found that one mutual fund distributor paid for some of its shelf space obligations by having its affiliated * See NASD Charges 15 Firms With Directed Brokerage Violations, Imposes Fines Totaling More Than $34 Million (press release issued by NASD, June 8, 2005), available at http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_014340&ssSourceNodeId=5. 2 investment adviser direct portfolio transactions to or for the benefit of broker-dealer firms to which the distributor owed revenue sharing fees. According to the NASD, the broker-dealers violated, among other rules, NASD Conduct Rule 2830(k), which prohibits member firms from favoring the sales of shares of particular mutual funds on the basis of brokerage commissions received by the firm. The NASD censored the 15 broker-dealers and imposed fines totaling more than $34 million. Jane G. Heinrichs Assistant

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