

MEMO# 19161

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BROKER-DEALER SETTLES NYSE CHARGES OVER FAILURE TO DELIVER FUND PROSPECTUSES AND ETF PRODUCT DESCRIPTIONS

©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. [19161] September 14, 2005 TO: BOARD OF GOVERNORS No. 44-05 CHIEF COMPLIANCE OFFICER COMMITTEE No. 58-05 CLOSED-END INVESTMENT COMPANY MEMBERS No. 49-05 COMPLIANCE MEMBERS No. 13-05 SEC RULES MEMBERS No. 98-05 SMALL FUNDS MEMBERS No. 76-05 RE: BROKER-DEALER SETTLES NYSE CHARGES OVER FAILURE TO DELIVER FUND PROSPECTUSES AND ETF PRODUCT DESCRIPTIONS The New York Stock Exchange announced the settlement of charges against a registered broker-dealer for failing to deliver prospectuses and product descriptions in connection with the sale of fund shares and exchange traded fund (“ETF”) shares, respectively.¹ The broker-dealer neither admitted nor denied guilt in settling the matter. The settlement is briefly described below. According to the NYSE, from October 2002 through March 2004, the broker-dealer failed to deliver prospectuses with respect to approximately 64,000 transactions in connection with certain sales of mutual fund shares. From January 2004 through July 2004, the broker-dealer failed to deliver prospectuses with respect to approximately 900 transactions in approximately 275 customer accounts in auction rate preferred stocks issued by closed-end funds.² The NYSE further found that, from the time it began to offer ETF shares until mid-November 2004, the broker-dealer failed to deliver product descriptions to certain customers because of system coding errors relating to 150 of the 156 ETFs offered by the broker-dealer. The NYSE determined that these violations resulted from supervisory and operational failures prompted by the absence of reasonable syndicate, trading, and operations departments’ procedures that would trigger the mailing of prospectuses and product descriptions as required. ¹ See NYSE Regulation Fines Merrill Lynch \$10 Million for Failure to Deliver Customer Prospectuses, Among Other Supervisory and Operational Failures (press release issued by NYSE, Aug. 15, 2005), available on the NYSE’s website at http://www.nyse.com/Frameset.html?displayPage=/press/2_2005.html. A copy of the settlement is available at <http://www.nyse.com/pdfs/05-087.pdf>. ² The settlement states that on December 31, 2004, the broker-dealer made rescission offers with respect to the affected transactions in both mutual fund and closed-end fund shares. ² The settlement covers several additional violations by the broker-dealer, including the failure to: (1) comply fully with an undertaking in a previous settlement of NYSE charges; (2) complete or maintain certain employee registrations; (3) preserve certain e-mail communications; and

(4) report to the NYSE certain litigation and arbitration judgments and customer complaints. In settling the matter, the NYSE hearing panel considered the broker-dealer's representations that it had enhanced, or was in the process of enhancing, certain of its policies and procedures. In particular, the broker-dealer represented that it had commenced a review of its prospectus and product description delivery policies, practices, and systems, and that it is developing a separate system of follow-up and review so that prospectus and product description coding and delivery procedures are regularly monitored. The broker-dealer agreed to a censure and payment of a \$10 million fine. With respect to its policies and procedures concerning certain NYSE reporting obligations, the broker-dealer agreed to retain, and to implement the recommendations of, an independent consultant. With respect to all other policies and procedures covered by the settlement, the broker-dealer agreed to undertake its own review and to report to the NYSE within 150 days that it has (or, within a reasonable time, will have) systems and procedures in place that are reasonably designed to comply with applicable laws and regulations. Rachel H. Graham
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