

MEMO# 15492

December 24, 2002

NASD REQUIRES IMMEDIATE ACTION REGARDING COMPLIANCE WITH BREAKPOINT SCHEDULES; SEC LETTER STRESSES IMPORTANCE OF ISSUE

[15492] December 24, 2002 TO: BROKER/DEALER ADVISORY COMMITTEE No. 51-02 COMPLIANCE ADVISORY COMMITTEE No. 115-02 SEC RULES MEMBERS No. 117-02 RE: NASD REQUIRES IMMEDIATE ACTION REGARDING COMPLIANCE WITH BREAKPOINT SCHEDULES; SEC LETTER STRESSES IMPORTANCE OF ISSUE The National Association of Securities Dealers (NASD) has issued a Notice to Members (NTM) directing all member firms to immediately review the adequacy of their existing policies and procedures to ensure that investors are charged the correct sales load on mutual fund transactions.* According to the NTM, staff of the NASD and SEC are concerned, based upon recent examinations, that some member firms have not been charging investors the correct sales loads, particularly in transactions involving letters of intent and rights of accumulation. Also, whereas in the past a mutual fund company had the opportunity to apply breakpoints in cases where the discount may not have been properly applied by the NASD member affecting the transaction, the use of automated processing and settlement systems, such as Fund/SERV, in which the underlying customer's identity may not be disclosed, may preclude the ability of the mutual fund company to monitor the member's compliance. As a result, members cannot rely on the mutual fund company to allocate the correct breakpoint to a transaction or override the member's failure to do so. NASD MEMBER OBLIGATIONS As noted in the NTM, the terms of the dealer agreement with a mutual fund company or complex generally requires the member to assure that the member provides the appropriate breakpoint in a given transaction or series of transactions. Regardless of whether the dealer agreement imposes this obligation, according to the NTM, a broker-dealer must:

- Ensure that its registered representatives and others involved in processing mutual fund transactions understand the terms of the offerings and reinstatements;
- Ascertain the information that should be recorded on the books and records of the member or its clearing firm, which is necessary in determining the availability and appropriate level of breakpoints;

* See Notice to Members 02-85 (December 2002). See also Letter from Annette L. Nazareth, Director, Division of Market Regulation and Paul F. Royce, Director, Division of Investment Management, SEC to Executive Representative, dated December 23, 2002. A copy of the NTM and the SEC's letter are available on the NASD's website, www.nasd.com. 2 • Apprise the customer of the breakpoint opportunity and inquire whether the customer has positions or transactions away from the member that should be considered in connection with a pending transaction;

- Make sure that the personnel processing these transactions are appropriately trained in order to ensure that the information pertaining to all aspects of a

mutual fund order, including any applicable breakpoint, is accurately transmitted in a manner retrievable by the mutual fund company; and • Have in place appropriate and sufficient procedures, including supervisory procedures, with respect to breakpoint calculations. SEC LETTER STRESSES IMPORTANCE OF IMMEDIATE COMPLIANCE WITH NTM To stress the importance of the NASD's NTM, the SEC has sent a copy of the NTM to NASD member firms with a letter signed by the Directors of the SEC's Divisions of Investment Management and Market Regulation. This letter is intended to ensure that member firms, as well as their chief legal and compliance officers, "are aware of, and take immediate action on," the issues raised in the NTM. According to the SEC's letter, the SEC will contact member firms "soon after the beginning of the new year to learn your assessment of the adequacy of your policies and procedures; whether your firm is in compliance with those policies and procedures and relevant NASD rules; and what assurances [the member] can offer on a going forward basis that it will comply fully with those policies and procedures." As expressed in the NTM, "NASD and SEC staff consider it essential that mutual fund executions are effected on the terms most advantageous to the customer." Tamara K. Salmon Senior Associate Counsel

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