

MEMO# 16475

August 27, 2003

NASD DIRECTS MEMBERS TO MAKE APPROPRIATE REFUNDS TO CUSTOMERS WHO DID NOT RECEIVE BREAKPOINTS FOR WHICH THEY WERE ELIGIBLE

[16475] August 27, 2003 TO: BROKER/DEALER ADVISORY COMMITTEE No. 28-03 COMPLIANCE ADVISORY COMMITTEE No. 66-03 SEC RULES MEMBERS No. 112-03 TRANSFER AGENT ADVISORY COMMITTEE No. 81-03 RE: NASD DIRECTS MEMBERS TO MAKE APPROPRIATE REFUNDS TO CUSTOMERS WHO DID NOT RECEIVE BREAKPOINTS FOR WHICH THEY WERE ELIGIBLE The NASD has issued Notice to Members 03-47 directing members to make appropriate refunds to customers who did not receive breakpoint discounts for which they were eligible.¹ According to the Notice, members should “take immediate steps” to make these refunds in accordance with the calculation guidelines set forth in the Notice to those customers who the broker-dealer knows, based upon the broker-dealer’s self-assessment² or otherwise, did not receive the sales load discount to which the customer was entitled. The Notice also directs members to make refunds to any customers who assert that they did not receive all applicable breakpoint discounts.³ According to the Notice, a member “may not place the burden of demonstrating entitlement to a refund upon the customer and, therefore, may not refuse to make a refund to a customer without first checking its own records to determine whether the customer is entitled to a refund.” The member may, however, require customers to produce documentation where the availability of a breakpoint discount can only be determined by records not held by the member. 1 A copy of this Notice, which was issued in August 2003, is available on NASD’s website at <http://www.nasdr.com/pdf-text/0347ntm.pdf>. NASD’s website also includes a calculator that members may use to compute the interest owed to customers under the refund guidelines set forth in the Notice. See http://www.nasdr.com/breakpoint_calculator/default.asp. 2 In March 2003, NASD directed each member firm that processed 100 or more automated purchases of front-end load mutual funds in 2001 or 2002 to conduct a “self-assessment” of its record of delivering breakpoint discounts to customers. 3 The Notice warns that a firm that does not respond “appropriately” to customer requests for refunds may be subject to disciplinary action by NASD. 2 The Notice requires members to follow these guidelines in providing refunds: • The refunds must be made in cash sent to the customer or through cash deposits made to an existing customer’s account with notice to that customer; • The refunds should be equal to the amount of the sales load overcharge plus interest at a simple rate of at least 2.5% for overcharges from January 1, 2001 to the present;⁴ and • The refunds should be made regardless of the performance of the mutual fund purchased by the customer. The Notice additionally discusses: a member’s duty to make and preserve records regarding refund

eligibility determinations and the calculation of refunds; the capital treatment of a member's refund liability; and, to the extent necessary, the need to segregate the funds needed to satisfy the member's refund liability through either a Special Reserve Bank Account for the Exclusive Benefit of Customer or through an account established for the benefit of customer in accordance with Rule 15c3-3 under the Securities Exchange Act of 1934. Tamara K. Salmon Senior Associate Counsel 4 As mentioned above in n.1, NASD's website includes a link to a calculator that may be used to compute this interest. For transactions that took place before January 1, 2001, members are required to use a comparable rate of interest. According to the Notice, any firm that has already provided refunds to its customers using an alternative methodology should contact the NASD to determine whether it calculated its refunds in a satisfactory manner. See n.3 to the Notice.

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