

MEMO# 17340

April 2, 2004

NASD ISSUES MEMBER ALERT RELATING TO FACILITATING REFUNDS OF MISSED BREAKPOINTS AND PROVIDES RELATED VERBAL GUIDANCE

[17340] April 2, 2004 TO: BROKER/DEALER ADVISORY COMMITTEE No. 10-04 COMPLIANCE ADVISORY COMMITTEE No. 39-04 OPERATIONS MEMBERS No. 16-04 SEC RULES MEMBERS No. 48-04 TRANSFER AGENT ADVISORY COMMITTEE No. 30-04 RE: NASD ISSUES MEMBER ALERT RELATING TO FACILITATING REFUNDS OF MISSED BREAKPOINTS AND PROVIDES RELATED VERBAL GUIDANCE As we previously informed you, in August 2003, the NASD issued a Notice to Members that directed members to “take immediate steps” to make appropriate refunds, in accordance with the NASD’s calculation guidelines, to those customers who the broker-dealer knows, based upon its self-assessment or otherwise, did not receive the sales load discount (breakpoints) to which the customer was entitled.¹ Subsequent to this mandate, the NASD learned that some firms “have experienced difficulty in locating certain customers and former customers and obtaining trade data necessary to effectuate refunds.” On March 30th, the NASD issued a Member Alert to address the difficulties its members have experienced.² The Member Alert reminds NASD members that they “must use their best efforts, taking all reasonable steps to locate customers and former customers.” It further notes that these “reasonable steps” might require NASD member firms to attempt to obtain the client’s current address from the mutual fund or mutual fund distributor involved, the fund transfer agent, or if the account has been transferred to another broker-dealer, from such broker-dealer. If, however, the mutual fund, fund distributor, transfer agent, or current broker-dealer will not provide the customer’s address, the member firm is directed to request that one or all of these third parties forward the material to the customer. 1 See Institute Memorandum to Broker/Dealer Advisory Committee No. 28-03, Compliance Advisory Committee No. 66-03, SEC Rules Members No. 112-03, and Transfer Agent Advisory Committee No. 81-03 [16475], dated August 27, 2003 discussed NASD Notice to Members No. 03-47 (Aug. 2003). A copy of the Notice to Members is available on the NASD’s website at <http://www.nasdr.com/pdf-text/0347ntm.pdf>. 2 A copy of the NASD’s Member Alert is available on the NASD’s website at: http://www.nasdr.com/mem_alert2004_06.htm. 2 ASSISTING NASD MEMBERS IN FULFILLING THEIR LEGAL OBLIGATIONS While the NASD’s Member Alert is only applicable to members of the NASD, to the extent an NASD member firm is unable, despite its best efforts, to locate a mutual fund customer or obtain the data necessary to effectuate refunds, the broker-dealer may ask a mutual fund, fund distributor, or transfer agent (collectively “the mutual fund”) to assist the broker- dealer in this process.

Towards this end, the Institute has conferred with the staff of the NASD, the Securities and Exchange Commission, and with industry participants regarding how the mutual fund might assist NASD members in this process. Based upon these discussions, the mutual fund industry might be asked to assist NASD member firms where the member has been unable to obtain, through sources other than the mutual fund,³ a current address on the investor. In such instances, the NASD member might contract a mutual fund to determine if the mutual fund can assist the member in obtaining the current address of the customer. To the extent an NASD member requests assistance in these situations, and the account currently resides on a transfer agent system and can, therefore, be accessed through an automated search (i.e., it has not been purged), the Institute strongly encourages our members to assist NASD member firms with this process, regardless of whether the account is opened or closed.⁴ However, to the extent the account has been purged (and is, therefore, no longer maintained on a transfer agent system that could be searched through automated means), we understand from our discussions with the regulators and the securities industry representatives that funds are not expected to conduct the manual searches of archived account or transaction data.

PRIVACY CONCERNS An additional issue that has arisen in connection with assisting broker-dealers in this process relates to privacy. In particular, concern has been expressed with whether a fund, its distributor, or transfer agent may share nonpublic personal financial information on an account holder with NASD member firms without violating the SEC's privacy regulation, Regulation S-P. In response to this concern, the NASD's Member Alert expressly states the NASD's view that "privacy laws are not a valid basis for refusing to provide customer account information for the purpose of providing customer notification or performing trade-by-trade analysis pursuant to a breakpoint discount refund program."⁵ According to the Member Alert, "the Securities and Exchange Commission staff concurs in this view."

³ As discussed in the Member Alert, these efforts might include, among other things, the NASD member researching its internal databases and historical records and utilizing other information database services to locate current addresses for customers (similar to those used to locate "lost security holders" as required under SEC Rule 17Ad-17). ⁴ Firms requesting additional assistance will need to provide each fund group certain information (such as fund CUSIP and customer account number) in an acceptable format in order for funds to perform an automated search to obtain current addresses that may be available on their transfer agent systems. ⁵ In support of this view, the Member Alert contains a link to a question and answer appearing on "Ask NASD; Quick Answers to Your Question." In particular, in response to a question regarding whether, "the privacy laws prevent sharing the customer account information necessary to provide customer notification or perform trade-by-trade analysis ordered by the NASD," the NASD's answer discusses the exceptions in Regulation S-P that permit financial institutions to make disclosures: (1) "to comply with federal, State, or local laws, rules, or other applicable legal requirements (including SRO requirements)" and (2) as necessary to effect, administer, or enforce a transaction that the customer requests or authorizes . . . [including] disclosures made to accrue or recognize incentives associated

³ The Member Alert additionally advises NASD members how to respond to third parties that are reluctant to share nonpublic personal information with the member out of a concern that the nonpublic personal account information will be used for purposes other than that for which it is shared. According to the Member Alert, the NASD member should "offer written agreements to relevant third parties to not use the information for any purpose other than effectuating breakpoint discount refund programs." Tamara K. Salmon Kathleen C. Joaquin Senior Associate Counsel Director – Operations & Distribution with a transaction, such as breakpoint discounts." See Sections 248.15(a)(7) and 248.14(a) of Regulation S-P, respectively.

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