

MEMO# 3929

July 13, 1992

INSTITUTE SUBMISSION TO NASAA COMMITTEE ON FUND LIABILITY FOR TELEPHONE TRANSACTIONS

July 13, 1992 TO: STATE SECURITIES MEMBERS NO. 34-92 SEC RULES COMMITTEE NO. 46-92 TRANSFER AGENT ADVISORY COMMITTEE NO. 38-92 RE: INSTITUTE SUBMISSION TO NASAA COMMITTEE ON FUND LIABILITY FOR TELEPHONE TRANSACTIONS

The Institute has been advised that certain states have expressed concern about disclosure in mutual fund prospectuses which sets forth the extent to which the mutual fund and their affiliates will be held liable for acting upon instructions in connection with telephone redemptions or exchanges. As you know, this issue is also under review by the Securities and Exchange Commission. (See Memorandum to SEC Rules Committee No. 28-91 and Transfer Agent Advisory Committee No. 25-91, dated May 16, 1991.) As a result of these states' concerns, the NASAA Investment Company Registration/Trading Practices Committee will be reviewing the basis for this type of disclosure. The Institute submitted the attached letter to the NASAA Committee which states that the limitation of liability in connection with telephone transactions does not violate the applicable provisions (i.e., Article 8) of the Uniform Commercial Code. In addition, the letter sets forth the various safeguards most mutual funds have implemented in order to protect against fraudulent telephone transactions as well as the criteria for ICI Mutual bond coverage for telephone transactions. The letter also discusses the current disclosure required by the SEC for funds that disclaim liability for acting upon certain telephone instructions as set forth in the most recent "generic comment letter". The Institute concludes by noting that if funds were to be held strictly liable with respect to telephone transactions, there could be an unintended result of harming those shareholders that do not engage in telephone transactions. The liability will have been shifted from those shareholders who have chosen to avail themselves of telephone privileges to all shareholders of the fund, since any investor losses borne by the fund (or increases in its insurance premiums) will reduce its earnings. The Institute will also be individually contacting the states that have expressed concern with the disclosure limiting liability of the fund for telephone transactions. We have been advised that California, Oklahoma, Texas and Vermont have expressed concern with this type of disclosure. Please contact me at (202) 955-3517 if you have heard from other states expressing concern with telephone disclaimers. We will keep you advised of developments.

Patricia Louie Assistant Counsel Attachment

abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.