

**MEMO# 18569**

February 25, 2005

## **NASD ACTION AGAINST MUTUAL FUND DISTRIBUTOR RELATING TO DIRECTED BROKERAGE**

[18569] February 25, 2005 TO: BROKER/DEALER ADVISORY COMMITTEE No. 4-05  
BROKER/DEALER ASSOCIATE MEMBERS No. 1-05 CHIEF COMPLIANCE OFFICER COMMITTEE  
No. 18-05 COMPLIANCE ADVISORY COMMITTEE No. 17-05 SEC RULES MEMBERS No. 32-05  
SMALL FUNDS MEMBERS No. 19-05 RE: NASD ACTION AGAINST MUTUAL FUND  
DISTRIBUTOR RELATING TO DIRECTED BROKERAGE The NASD announced the filing of a disciplinary action against a distributor to a group of mutual funds ("Funds") alleging violations of NASD Rules relating to directed brokerage.\* The action alleges that the distributor directed approximately \$100 million in brokerage commissions over a three-year period to about 50 brokerage firms that were the top sellers of the Funds. According to the complaint, between January 2001 and December 2003, the distributor entered into yearly sponsorship arrangements with approximately 50 NASD member firms that were the top sellers of the Funds. As part of these sponsorship arrangements, the distributor arranged for approximately \$100 million of brokerage commissions generated by the Funds' portfolio trades to be directed to these firms to reward past sales and to encourage future sales. The complaint states that the distributor calculated "target commissions" that it intended to direct to each of the top-selling firms according to a formula that was based upon each firm's prior year's sales of the Funds. The distributor also allegedly discussed with the top-selling firms the benefits that the distributor expected to receive pursuant to the sponsorship arrangements, such as the inclusion of the Funds on the firms "preferred fund" or "recommended fund" lists, and enhanced access to the firms' sales forces. Finally, the complaint alleges that at the beginning of each year during the relevant time period, the distributor provided a chart to the Funds' investment adviser that listed each of the firms with which the distributor had a sponsorship arrangement and their amount of "target commissions" for each firm. According to the complaint, the distributor's trading desk directed brokerage commissions on the Funds' portfolio transactions to the firms on the chart based upon the "target commissions" set by the distributor for each firm. \* See Department of Enforcement v. American Funds Distributors, Inc., CRD No. 6247, NASD Office of Hearing Officers, Disc. Proceeding No. CE3050003 (Feb. 16, 2005). A copy of the complaint is attached. 2 The complaint alleges that the distributor violated NASD Conduct Rules 2830(k) and 2110 by: (1) entering into sponsorship arrangements in which it offered or promised brokerage commissions to other firms as a condition to the sale or distribution of the Funds' shares; and (2) arranging that the Funds' investment adviser direct to the top-selling firms a percentage of directed brokerage commissions, which amount was conditioned upon that firm's sales or promise of sales of the Funds' shares. The complaint seeks sanctions, including disgorgement, restitution, and costs. The distributor has 25 days

from service of the complaint to respond to the charges. Jane G. Heinrichs Assistant Counsel Attachment (in .pdf format) Note: Not all recipients receive the attachment. To obtain a copy of the attachment, please visit our members website (<http://members.ici.org>) and search for memo 18569, or call the ICI Library at (202) 326-8304 and request the attachment for memo 18569.

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