INVESTMENT COMPANY INSTITUTE

MEMO# 5433

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NASD NOTICE TO MEMBERS CONCERNING REINVESTMENT OF MATURING CSS IN MUTUAL FUNDS

December 29, 1993 TO: BANK INVESTMENT MANAGEMENT MEMBERS NO. 37-93 BOARD OF GOVERNORS NO. 116-93 SUBCOMMITTEE ON ADVERTISING NO. 22-93 RE: NASD NOTICE TO MEMBERS CONCERNING REINVESTMENT OF MATURING CSs IN MUTUAL FUNDS ____ The NASD recently published the attached Notice reminding its members, "particularly members affiliated with banks or participating in bank networking arrangements," of their obligations under the Rules of Fair Practice to disclose to customers the varying risks of investing the proceeds of deposits in a security, such as a mutual fund. The Notice reminds all members "that they are subject to the full scope of NASD regulations." The Notice is designed in part to prevent investor misunderstandings that could lead to violations of NASD rules and regulations. According to the Notice, "NASD regulatory staff will be examining all members, including those who are bank affiliates and who are providing networking arrangements for banks, for compliance with such regulations." The Notice states that members should provide, at a minimum, the following disclosure to customers in connection with mutual fund investment alternatives: - for money market funds -- although fund managers strive to maintain a stable net asset value, such funds are not federally insured and there is no guarantee that a stable net asset value will be maintained; - for fixed-income funds -- although such funds may pay higher rates than CDs, their net asset values are sensitive to interest-rate movement and a rise in interest rates can result in a decline in the value of the customer's investment; and - for equity funds -- there is a higher degree of risk to capital associated with these funds. The Notice states that many first-time investors may use the services and products provided by a broker-dealer affiliated with a bank. For this reason, it states that these NASD members have "a higher level of responsibility" to ensure that investors understand the differences between deposit products offered by the bank and investments offered by the broker-dealer, and to ensure that suitability and supervision standards are strictly followed. It reminds members that they must have procedures requiring registered persons to reiterate to customers "in all oral and written communications" the material differences between bank instruments and securities. The Notice also states that bank affiliated members and members participating in bank networking arrangements must be particularly sensitive to the potential for customer confusion about mutual fund purchases made at bank branch locations. Advertising and sales presentations should disclose that mutual fund shares purchased through banks "are not deposits or obligations of, or guaranteed by, the bank and are not federally insured or otherwise guaranteed by the federal government." Members may wish to obtain signed acknowledgements from their customers that they have received and understand these disclosures. Members should provide customers these disclosures on an annual basis. The Notice states that members should advise their affiliates that unregistered bank employees should provide similar disclosures when they discuss with customers the reinvestment of CDs in mutual funds, and should review the activities of unregistered employees to ensure that they do not require NASD registration. Members also should advise their affiliates to use appropriate signs or labels near the investment area to distinguish the operation from the bank's traditional deposit-taking functions. We will continue to advise you of developments in this area. Paul Stevens General Counsel Attachment