

MEMO# 4963

July 9, 1993

NASAA COMMITTEE ISSUES REVISED PROPOSED TELEPHONE GUIDELINES FOR PUBLIC COMMENT

July 9, 1993 TO: OPERATIONS COMMITTEE NO. 23-93 SEC RULES COMMITTEE NO. 61-93
STATE LIAISON COMMITTEE NO. 26-93 TRANSFER AGENT ADVISORY COMMITTEE NO. 38-93
RE: NASAA COMMITTEE ISSUES REVISED PROPOSED TELEPHONE GUIDELINES FOR PUBLIC
COMMENT _____ As we previously
informed you, earlier this year, the NASAA Investment Companies Committee ("NASAA
Committee") issued "Proposed Guidelines for Telephone Transactions" ("Proposed
Guidelines") for public comment which would have required compliance with "minimum
standards and requirements" if a mutual fund disclaims strict liability for acting upon
telephone instructions. The Institute, and several of its members, submitted written
comments opposing adoption of the Proposed Guidelines and also attended an open
meeting of the NASAA Committee to further express opposition to certain of the minimum
standards and requirements in the Proposed Guidelines because such were inconsistent
with current industry procedure and practice. (See Memoranda to Operations Committee
Nos. 1-93 and 12-93, SEC Rules Committee Nos. 5-93 and 24-93, State Liaison Committee
Nos. 1-93 and 16-93 and Transfer Agent Advisory Committee Nos. 4-93 and 22-93, dated
January 15, 1993 and March 19, 1993.) In response to the written and oral comments
received in opposition to the Proposed Guidelines, the NASAA Committee has revised the
Proposed Guidelines ("revised Proposal") and recently re-issued such for public comment.
The Institute is pleased to inform you that the revised Proposal does not include mandated
procedures a fund must comply with if it disclaims liability for acting upon telephone
instructions. In particular, the revised Proposal does not require shareholder election of
telephone services or shareholder selection of a personal password or identification
number. According to the revised Proposal, mutual funds have a duty to exercise
reasonable care to determine that telephone instructions are genuine. The revised Proposal
also provides that a mutual fund may not disclaim liability for losses due to unauthorized or
fraudulent telephone instructions unless the fund has established and follows procedures
reasonably designed to prevent such losses. In determining whether or not the procedures
established by the fund are reasonable, the fund may take into account the cost of such
procedures and the risk of loss. The revised Proposal further provides that a mutual fund
may not disclaim liability for acting upon telephone instructions it reasonably believes to be
genuine unless the fund's prospectus and the document in which the investor authorized
telephone transactions includes the following information: (1) a description of the fund's
policy regarding exculpation from liability in the event of a fraudulent telephone
transaction; (2) a statement whether the privilege to initiate transactions by telephone will
be made available to shareholders automatically or upon the investor's affirmative request;

(3) a statement that the investment company will employ reasonable procedures to confirm that telephone instructions are genuine and that, if it does not, it may be liable for losses due to unauthorized or fraudulent transactions; (4) a description of the procedures the fund follows for telephone transactions; and (5) a prominent statement that the investor, as the result of this policy, bears the risk of loss. The foregoing provisions are similar to the position the Division of Investment Management has taken with respect to the propriety of disclaimers of liability for telephone transactions. As you may recall, the Division has also taken the position that funds are responsible for exercising reasonable care to prevent losses due to unauthorized telephone transactions. Moreover, the Division requires certain specified disclosure in a fund prospectus and in any other document describing transactions initiated by telephone. Although the disclosure items required by the Division and set forth in the revised Proposal are similar, the revised Proposal requires that such disclosure be included in the prospectus and document in which an investor authorizes telephone transactions. (The letter to the Institute from the Division of Investment Management, dated April 19, 1993 outlining its position on disclaimers was previously distributed but is attached for your convenience.) Attached is a copy of the revised Proposal issued by the NASAA Committee. The comment period on the revised Proposal expires on Friday, August 13, 1993. Written comments should be mailed to each member of the NASAA Committee as well as the NASAA General Counsel. Please provide me with your comments on the revised Proposal no later than Wednesday, August 4, 1993. My direct telephone number is 202/955-3517. Patricia Louie Associate Counsel Attachments