

MEMO# 16248

June 27, 2003

NASD ISSUES INVESTOR ALERT ON CLASS B MUTUAL FUND SHARES

[16248] June 27, 2003 TO: COMPLIANCE ADVISORY COMMITTEE No. 51-03 SEC RULES MEMBERS No. 83-03 RE: NASD ISSUES INVESTOR ALERT ON CLASS B MUTUAL FUND SHARES In conjunction with issuing a recent enforcement action relating to the unsuitable sale of Class B shares of a mutual fund by a broker-dealer, NASD has published a NASD Member Alert, Class B Mutual Fund Shares: Do They Make the Grade * The Alert is summarized below. The Alert was issued based on NASD's concern that investors may purchase Class B shares when it would have been more cost-effective to purchase another class of shares. The Alert discusses in detail the differences between mutual fund share classes A, B, and C and provides investors with information to enable them to evaluate which class may be appropriate. This discussion includes an explanation of contingent deferred sales loads, breakpoints (which it notes are not available to purchasers of Class B shares), and 12b-1 fees. It also suggests some questions an investor may want to ask his or her investment professional before investing. The Alert notes that the only difference between classes is how much the investor will pay in expenses and how much the investor's broker will be paid for selling the fund. For those investors that already own Class B shares, the Alert encourages them to keep track of when they are scheduled to convert to Class A shares. The Alert discusses no-load mutual funds as an option to mutual funds with sales loads. It notes, however, that because such shares are purchased directly from a mutual fund company or brokerage firm fund supermarket, the investor will not receive the assistance of a broker or an investment professional. The Alert also discusses four enforcement actions involving abuse relating to the unsuitability of large sales of Class B shares. In three of these cases, the brokers' sales of Class B shares were found to be unsuitable because it would have been more cost-effective for the investors to be in Class A shares. In the fourth case, the broker was charged with securities fraud, in part, for recommending that customers purchase large volumes of Class B shares, some of which were held for short periods of time (i.e., in one case, just 10 days). * The Alert can be found on NASD's website at: http://www.nasdr.com/alert_classb_funds.htm. 2 For an investor considering a recommendation to purchase Class B shares, the Alert offers the following advice: check out the fund; use NASD's Mutual Fund Expense Analyzer to help decide whether to buy Class A, B, or C shares or any other share class offered; and show your knowledge as an investor by asking the broker or financial adviser the following questions:

- Which class of shares is best for me, keeping in mind the amount of my investment and the length of time I plan to own the mutual fund?
- Would you put in writing why, given my time horizon and the amount of the purchase, you think it would be more beneficial for me to purchase Class B shares rather than another class of shares?
- What breakpoints are available if the same amount of Class A fund shares were to be purchased instead of Class

B shares? • How much will you be paid for selling me Class B shares, and how much for selling me other classes of shares? Finally, the Alert recommends that if the investor's broker asks the investor to sign a written disclosure agreement stating that it is the investor's choice to buy Class B shares, the investor should make sure that he or she reads the agreement and understands it. If the investor believes a sale of Class B shares was improper, the Alert notes that the investor can file a complaint with NASD. Tamara K. Salmon Senior Associate Counsel

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