# Workshop: Mutual Funds – Solving Problems

## SIFMA Compliance & Legal Division's 2009 Annual Seminar

**Phoenix, AZ**

**March 25, 2009**


Henry Sanchez, Jr., LPL Financial (Moderator)
John Ayanian, Morgan, Lewis & Bockius LLP
Barry Barbash, Willkie Farr & Gallagher
David Hebner, Wachovia Securities LLC
James Shorris, FINRA

## Workshop: Mutual Funds – Solving Problems [1]

I. **Revenue Sharing Arrangements.**

A. Revenue sharing arrangements generally involve payments that are made by a fund's investment adviser to compensate brokers, dealers and other financial institutions, for distribution, shareholder and administrative services provided to funds. Under these arrangements, a fund may receive preferential treatment by a broker-dealer's sales personnel over other funds sold by the broker-dealer. Revenue sharing arrangements raise two primary sets of issues: issues for mutual funds and their advisers arising under Rule 12b-1 under the Investment Company Act of 1940 ("1940 Act"), and disclosure issues for broker-dealers. Of these two issues, the disclosure issue has been more problematic due to regulatory ambiguities.

B. Revenue sharing payments may be found to be an indirect use of fund assets to finance the distribution of fund shares if any allowances were made in the advisory fee to finance distribution. Conversely, revenue sharing would not involve an indirect use of fund assets for distribution if the adviser makes revenue sharing payments from the profits of its advisory fee that are "legitimate" and "not excessive" (*i.e.*, payments derived from an advisory contract that does not result in a breach of the adviser's duty under Section 36(b)).[2]

C. **Related Regulatory Requirements.**

1. **Rule 12b-1 under the 1940 Act.**

a. An investment company may not use fund assets, directly or indirectly, to finance the distribution of fund shares, except under a Rule 12b-1 Plan. Among other things, Rule 12b-1 prohibits funds from using their portfolio brokerage commissions to finance the distribution of the fund's shares.

(i) Rule 12b-1(h)(1) provides that a fund may not compensate a broker-dealer for any promotion or sale of shares issued by the fund by directing to the broker-dealer: (1) the fund's portfolio securities transactions; or (2) any remuneration, including commissions and mark-ups, received or to be received from the fund's portfolio transactions effected through any other broker-dealer.

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1 The panelists thank Michael Berenson, T.R. Lazo, and Ryan Gibbs of Morgan, Lewis & Bockius, LLP for their assistance with this outline.

2 The Securities and Exchange Commission ("SEC") has recognized that an adviser may finance fund distribution out of its "legitimate profits." *See* Investment Company Act Release No. 16431 (June 13, 1988). Whether profits are legitimate depends on whether the compensation received by the adviser is "so disproportionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arm's length bargaining." *See Gartenberg v. Merrill Lynch Asset Management, Inc.,* 694 F.2d 923, 928 (2d Cir. 1982); *see also Gartenberg v. Merrill Lynch Asset Management, Inc.*, 740 F.2d 190, 19 (2d Cir. 1984).

(ii) Rule 12b-1(h)(2) provides that a fund may not direct its portfolio securities transactions to a broker-dealer that distributes shares of the fund unless the fund has implemented policies and procedures reasonably designed to prevent: (1) the persons responsible for directing the fund's portfolio securities transactions from taking into account a broker-dealer's distribution of the fund's shares in directing the transactions to a broker-dealer; and (2) the fund, as well as the fund's adviser and principal underwriter, from entering into any agreement or understanding (whether written or verbal) under which the fund directs portfolio securities transactions to a broker-dealer in consideration for the broker-dealer's distribution of shares of the fund.

2. **Rule 10b-10 under the Securities Exchange Act of 1934 ("Exchange Act"): Confirmation Requirements.**

a. Rule 10b-10 under the Exchange Act requires broker-dealers to issue trade confirmations to customers that disclose, among other things, the amount of any remuneration that will be received by the broker from a customer in connection with the transaction, and the source or amount of any other remuneration to be received by the broker in connection with the transaction.

b. **Applicability of Rule 10b-10 to Mutual Fund Transactions.**

(i) In 1979, the SEC staff granted no-action relief to the Investment Company Institute ("ICI") under Rule 10b-10 to allow funds to send confirmations that did not disclose "the sales load or any other charges in connection with the transaction," provided the customer had received, at or before completion of the transaction, a prospectus that disclosed "the precise amount of the sales load or other charges or a formula that would enable the customer to calculate the precise amount of those fees."[3]

(ii) The SEC staff, in a subsequent letter to the ICI, indicated that it was reconsidering this position because it no longer believed that non-disclosure of commissions on investment company transactions is appropriate.[4] The letter stated that, while the prospectus discloses sales loads and other fees, the SEC staff believed the broker-dealer should disclose its transaction related compensation as it would in other secondary market transactions. However, the SEC staff never withdrew the 1979 letter so the positions contained in the letter remain in effect.

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3 *Investment Company Institute*, SEC No-Action Letter (Apr. 18, 1979).

4 Letter from Brandon Becker, Director, Division of Market Regulation, to Paul Schott Stevens, General Counsel, ICI (Mar. 16, 1994).

c. **Applicability of Rule 10b-10 to Revenue Sharing Payments.**

(i) Rule 10b-10 does not explicitly address the amount of detail that must be included in the disclosure of revenue sharing payments that are made out of an adviser's or distributor's own resources.

(ii) This question was presented to the U.S. Court of Appeals for the 2nd Circuit in the *Press v. Quick & Reilly Inc.* case. Investors alleged that broker-dealers defrauded them by failing to disclose fees they had received from advisers to certain money market sweep funds that the broker-dealers had selected for customer cash balances.[5]

(iii) The SEC filed an *amicus* brief in the *Quick & Reilly* case, which reiterated its position that, as a general principle, the delivery of a prospectus containing sufficient disclosure may satisfy a broker-dealer's disclosure obligations under Rule 10b-10. In addition, the SEC acknowledged that "there is no precise standard as to how much disclosure the Rule currently requires" and that, with respect to fees paid by a fund's adviser out of its own resources, "the SEC has not provided specific guidance with regard to the disclosure, if any, required in fund prospectuses for these types of payments."

(iv) Based on the SEC's *amicus* brief, and consistent with the SEC's interpretation in the 1979 letter to the ICI, the court held that the disclosure required by Rule 10b-10 could be included in the prospectus and Statement of Additional Information ("SAI") and was not specifically required to be in the confirmation sent by the broker-dealer.

3. **FINRA's NASD Rule 2830(l)(4): Member Compensation.**

a. Applies to broker-dealers that are members of FINRA[6] (formerly, the National Association of Securities Dealers ("NASD")) and requires disclosure of compensation received by broker-dealers for the sale of fund shares.

b. **Disclosure Requirements.**

(i) All "cash compensation" must be described in a current prospectus. "Compensation" expressly includes any non-cash compensation. "Cash compensation" is "any discount, concession, fee, service fee, commission, asset-based sales charge, loan, override, or distribution of investment company securities."

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5 *Press v. Quick & Reilly, Inc.*, 218 F.3d 121 (2nd Cir. 2000).

6 FINRA (formally, the "Financial Industry Regulatory Authority") was created in July 2007 through the consolidation of the member regulation functions of NASD, Inc. ("NASD") and the New York Stock Exchange ("NYSE").

(ii) If "special cash compensation" arrangements are entered into that "are not made available on the same terms to all members" participating in the distribution, then the prospectus must include disclosure of the name of the member in question and the "details of the arrangements."

c. FINRA has acknowledged that the term "special compensation" is subject to varied interpretation. In addition, FINRA has stated that the "interpretive ambiguity has resulted in a wide array of disclosure practices by offerors regarding special cash compensation, ranging from specific to very general disclosure, or, in some cases, no disclosure.[7]

d. While FINRA has not provided any formal clarification as to whether revenue sharing arrangements fall within the definition of the term "special cash compensation," it has enforced this provision. In *Pilgrim Distributors Corp.*, FINRA brought an action under Rule 2830(l)(4) for a sales contest that was held without stickering the fund prospectus to disclose the existence of the contest.[8] In this case, the distributor paid affiliated broker-dealers a 1% bonus to be passed on to individual brokers selling fund shares. FINRA construed the promotion to be "special compensation" as it did not apply equally to all broker-dealers.

**4. FINRA Prohibition on Practices Related to Directed Brokerage: FINRA's NASD Rule 2830(k).**

a. NASD Rule 2830(k) generally prohibits FINRA member broker-dealers from favoring the sale of shares of any fund based on brokerage commissions received or expected to be received from the fund or any other source.

b. In particular, Rule 2830(k)(2) expressly provides that a broker-dealer may not sell shares, or act as principal underwriter for, a fund that the broker-dealer "knows or has reason to know" engages in directing portfolio securities transactions to any broker-dealer in consideration for the promotions or sale of shares issued by the fund. As such, Rule 2830(k) prohibits the sale and distribution of shares of a fund if the fund has a directed brokerage arrangement with another broker-dealer.

c. Notwithstanding the prohibitions, Rule 2830(k)(8)(A) provides that, as long it does not violate any of the specific provisions of 2830(k), a FINRA member broker-dealer may execute portfolio securities transactions for a fund whose shares the member sells, or for which the member acts as principal underwriter.

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7 FINRA Notice to Members 96-68 (Oct. 1996); FINRA Notice to Members 97-50 (Aug. 1997).

8 *In the Matter of District Business Conduct Committee for District No. 2 v. Pilgrim Distributors Corp.*, (Sept. 26, 1994) (sanctions upheld on appeal to the SEC, *In the Matter of Robert A. Grunburg*, Securities Exchange Act Release No. 36182 (Sept. 1, 1995) and Release No. 37895 (October 30, 1996)).

D. **SEC Revenue Sharing Enforcement Actions.**

1. While the regulators have not provided any formal guidance on the amount or content of required disclosure for revenue sharing payments, the SEC has brought a number of enforcement actions relating to the non-disclosure of revenue sharing arrangements, particularly where the use of such arrangements have led to the creation of "preferred lists" that explicitly favor the distribution of certain funds.

2. The central case brought by the SEC was *Morgan Stanley DW Inc.* In the *Morgan Stanley* case, the SEC brought an enforcement action alleging that Morgan Stanley violated Rule 10b-10 because the relevant fund prospectuses failed to adequately disclose that Morgan Stanley operated an "Asset Retention Program" (also known as its Preferred Partners Program) where select mutual fund advisers or distributors paid Morgan Stanley 15 – 20 basis points on gross sales of fund shares and 5 basis points on assets raised through the Preferred Partners Program that were held for more than one year. The fees were passed on to the Morgan Stanley registered representatives who sold the shares.[9]

a. The SEC found that Morgan Stanley did not adequately disclose the "source and amount" of the remuneration it received from advisers and distributors "in connection with" transactions in mutual fund shares when it relied on the disclosure contained in the fund's prospectuses and SAIs.

b. The SEC also found that the disclosure did not adequately describe the conflicts of interest created by the Preferred Partners Program. For example, the disclosure did not explain that in exchange for brokerage commissions sent to Morgan Stanley or its affiliates, the funds received enhanced sales and marketing services from the broker-dealers.

3. In *Oppenheimerfunds, Inc.* the SEC found that Oppenheimer inappropriately directed fund brokerage commissions to offset the adviser's revenue sharing obligations to broker-dealers.[10] The SEC found that this practice was not adequately disclosed in fund prospectuses or to the fund's board of directors.[11] Unlike other revenue sharing settlements, the SEC acknowledged Oppenheimer's cooperation in the investigation and only required Oppenheimer to disgorge any monetary benefits and pay an interest penalty.

4. Similarly, in *Capital Analyst Incorporated* ("CAI"), the SEC alleged that CAI sold funds from mutual fund complexes participating in its revenue

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9 *In the Matter of Morgan Stanley DW Inc.*, Securities Exchange Act Release No. 8339 (Nov. 17, 2003).

10 *In the Matter of Oppenheimerfunds, Inc. and Oppenheimerfunds Distributor, Inc.*, Investment Company Act Release No. 27065 (Sept. 14, 2005).

11 In September 2004, the SEC amended Rule 12b-1 under the 1940 Act to prohibit the use of fund brokerage to compensate broker-dealers for selling fund shares. *See* Investment Company Act Release No. 26591 (Sept. 2, 2004).

sharing program, called the Product Sponsor Tier Program ("Tier Program"), without fully disclosing material information to its customers regarding the program. Under its Tier Program, CAI provided participating mutual fund complexes increased access to and visibility within CAI's retail distribution network in exchange for compensation in the form of preferred marketing payments. However, the SEC claimed that CAI failed to adequately disclose to its customers the existence of the Tier Program and the conflict of interest created by these payments. Pursuant to the settlement, the SEC ordered that CAI pay disgorgement and a civil money penalty, required CAI to place and maintain on its website disclosures regarding its Tier Program and required CAI to retain an independent consultant to conduct a comprehensive review of CAI's disclosures.[12]

E. **Revenue Sharing Disclosure Trends.**

1. Due to the lack of clarity in the regulatory regime surrounding revenue sharing arrangements, a number of best practices have emerged regarding shareholder disclosure.

2. The SEC has required firms to adhere to certain conditions in settling enforcement proceedings relating to revenue sharing. For example, in the Morgan Stanley action, in addition to agreeing to provide more detailed disclosure in the funds' SAIs, Morgan Stanley agreed to provide detailed disclosures on its website concerning its Preferred Partners Program and also agreed to prepare a "Mutual Fund Bill of Rights" that contained similar disclosures.[13]

3. The conditions imposed in enforcement actions have served as a benchmark for disclosure since there are no clear regulatory standards. Accordingly, many other mutual fund companies, investment advisers and brokers also provide similar information on their websites.

F. **Regulatory Responses.**

1. **SEC Proposal Regarding Confirmation and Point of Sale Disclosure for Mutual Fund Transactions.** On January 29, 2004, the SEC issued a rulemaking proposal under which broker-dealers would be required to provide increased disclosure to customers in connection with transactions in mutual funds, unit investment trusts, and 529 plans (collectively, "covered securities").[14] The SEC proposed changes in three areas: Point of Sale Disclosure, Confirmation Disclosure, and Prospectus Disclosure. To date, the SEC has not taken final action on the proposal, and it has not indicated when, or whether, it plans to do so.

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12 *In the Matter of Capital Analyst Incorporated*, Release No. 34-51414, 85 S.E.C. Docket 13, 2005 WL 673607 (March 23, 2005).

13 *See also In re Edward D. Jones & Co. L.P.*, Securities Exchange Act Release No. 50910 (Dec. 22, 2004).

14 Securities Exchange Act Release No. 49148 (February 10, 2004).

a. **Point of Sale Disclosure.**

(i) Proposed Rule 15c2-3 under the Exchange Act would require broker-dealers to provide disclosure to customers *prior* to effecting covered transactions. Under the point of sale disclosure requirements, broker-dealers would be required to disclose each of the following categories of information, either by reference to the value of the particular transaction, or by reference to a model investment of $10,000:

(A) The amount of any sales load that the customer would incur at the time of purchase;

(B) An estimate of the amount of any asset-based sales charge and asset-based service fees[15] that the issuer would incur in the year following the purchase;

(C) An estimate of the maximum amount of any deferred sales load that the customer would incur if the shares were sold within one year, along with a statement informing the customer about how many years a deferred sales load may be in effect; and

(D) The amount of any dealer concession[16] that the broker-dealer would earn in connection with the transaction.

(ii) A broker-dealer's point of sale disclosure also would have to include information about certain of the broker-dealer's practices, including:

(A) Whether the broker-dealer, or any affiliate, receives revenue sharing from the fund complex;[17]

(B) Whether the broker-dealer, or any affiliate, receives portfolio brokerage commissions from the fund complex; and

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15 Under the proposal, asset-based sales charges would be all asset-based charges incurred in connection with the distribution of a covered security, paid by the investor or paid out of the assets of covered securities owned by the investor, and asset-based service fees would be all asset-based amounts for personal service and/or the maintenance of shareholder accounts, paid by the investor or paid out of the assets of covered securities owned by the investor.

16 Under the proposal, a dealer concession would be any fees that the broker-dealer will earn in connection with the transaction from the issuer of the covered security, an agent of the issuer, the primary distributor of the covered security, or any other broker-dealer.

17 Under the proposal, the term "fund complex" would include the issuer of the covered security, the issuer of any other covered security that holds itself out to investors as a related company for purposes of investment or investor services, any investment adviser for the issuer, and affiliates of the issuer or the investment adviser.

(C) Whether the broker-dealer engages in differential compensation practices related to the covered security.

(iii) In addition to requiring broker-dealers to provide disclosure regarding covered transactions at the point of sale, Proposed Rule 15c2-3 would allow customers to terminate orders in covered securities made prior to receiving the point of sale disclosure. Under the proposed rule, an order that a broker-dealer received from a customer prior to providing the point of sale disclosure to the customer would be treated as an indication of interest until after the point of sale disclosure is provided to the customer, and, following disclosure, the customer has had an opportunity to determine whether to place an order. The broker-dealer would be required to disclose the termination right to the customer at the time it provided the point of sale disclosure.

b. **Confirmation Disclosure.**

(i) Proposed Rule 15c2-2 under the Exchange Act would require broker-dealers to provide specific confirmation disclosures in connection with transactions in covered securities. Proposed Rule 15c2-2 would define "revenue sharing" as any arrangement or understanding by which a person within a fund complex, other than the issuer of the security, pays a broker or dealer, or any associated person of the broker or dealer, apart from dealer concessions or other sales fees that would be disclosed under the rule. This definition would cover shelf space payments.

(ii) **General Disclosures.** Under the proposed rule, broker-dealers would be required to provide certain general disclosures regarding covered securities, many of which are required pursuant to the SEC's current confirmation requirements under Rule 10b-10. In particular, confirmations for transactions in covered securities would have to disclose:

(A) Any commission, markup or other remuneration received or to be received by the broker-dealer from the customer in connection with the transaction.

(B) The amount of any deferred sales load that the customer has incurred or will incur in connection with the transaction.

(iii) **Additional Disclosures for Purchases of Covered Securities.** Proposed Rule 15c2-2 also would require confirmation disclosure of information relating to purchases of covered securities. A few examples of such disclosures are:

(A) The amount of any sales load that the customer would incur along with information about the availability of breakpoints with regard to the covered security;

(B) An explanation of the potential amount of any deferred sales load that the customer might incur in connection with any subsequent sale of the shares;

(C) An explanation of asset-based sales charges and asset-based service fees that the issuer would incur in connection with the customer's purchase of the shares; and

(D) The amount that the broker-dealer and its associated persons would earn, directly or indirectly, from the fund complex.

c. **Prospectus Disclosure.** The SEC also proposed specific amendments to Form N-1A that would require funds to increase the amount of disclosure regarding sales loads and revenue sharing. Under the proposal, the fee table in Form N-1A would be amended to require the maximum front-end sales load as well as deferred sales loads to be shown as a percentage of net asset value rather than as a percentage of offering price. Similarly, if a fund imposed more than one type of sales load (*e.g.*, a deferred sales load and a front-end sales load), the fund would be required to show the aggregate load in the Form N-1A fee table as a percentage of net asset value.

II. **Disclosure of Breakpoints.**

A. Mutual funds that offer shares for purchase to investors subject to front-end sales loads often provide investors with the opportunity to pay reduced loads under a variety of circumstances. The specified levels of dollar investment at which the front-end sales charge is reduced are set by fund companies and are generally known as "breakpoints."

B. Investors may be entitled to a reduced front-end sales charge based on the dollar amount of a single transaction. Investors may also be entitled to receive breakpoints in purchasing fund shares through the means of a letter of intent ("LOI") or based on a right of accumulation ("ROA"). An LOI is a statement signed by the investor indicating his or her intent to purchase a certain amount of fund shares over a stated period of time. An ROA is the discount or breakpoint received in a current mutual fund transaction based on the cumulative value of previous transactions.

C. Fund managers and fund distributors may face significant difficulty in monitoring the application of stated breakpoints. The difficulty in part results from breakpoint schedules varying, sometimes dramatically, from fund family to family. Monitoring breakpoints has also been made difficult by the advent of automated processing and settlement systems that have resulted in a large number of transactions in a mutual fund's shares with respect to which the underlying investor's identity may not be known to the fund or its distributor.

D. **FINRA's Special Notice to Members.**

1. In December 2002, FINRA issued Special Notice to Members 02-85 directing each of its member firms that sells mutual fund shares "to immediately review the adequacy of its policies and procedures to ensure that they are designed and implemented so that customers are charged the correct sales loads on mutual fund transactions." FINRA required each such firm to retain a record of its review and the results for FINRA's examination.

2. According to the Notice, a broker-dealer must:

a. Ensure that its registered representatives and other personnel engaged in processing mutual fund transactions understand the terms of the offerings and reinstated transactions;

b. Identify the information that should be recorded on the books and records of the member or its clearing firm, and that is necessary in determining the availability and appropriate level of breakpoints;

c. Inform a customer of breakpoint opportunities and inquire whether the customer has positions or transactions away from the member firm that should be considered in connection with a pending purchase transaction;

d. Make sure that the personnel processing mutual fund transactions are appropriately trained to ensure that the information pertaining to all aspects of a mutual fund order, including any applicable breakpoint, is accurately transmitted in a manner retrievable by the mutual fund company; and

e. Have in place appropriate and sufficient procedures, including supervisory procedures, with respect to breakpoint calculations.

3. The Notice also clarified that the introducing broker must ensure that its customers receive the appropriate breakpoint in a specific mutual fund transaction, unless the clearing broker expressly assumes the obligation.

4. Shortly after issuing the Notice, FINRA issued an Investor Alert describing breakpoints and how investors may be able to protect themselves with respect to breakpoints. *Mutual Fund Breakpoints: A Break Worth Taking*, FINRA Investor Alert (Jan. 14, 2003). The Investor Alert provides investors with a description of how breakpoints work and what actions investors should take if they did not receive a breakpoint discount they believe they should have.

E. **Breakpoint Task Force.**

1. In response to developments regarding breakpoint disclosure, a joint NASD/Industry Task Force (the "Industry Task Force") was established to recommend industry-wide changes that could prevent future breakpoint problems.[18] The Industry Task Force recommended improvements to a variety of practices, including the following:

a. Developing a standardized checklist for representatives to use to ensure they provide customers with appropriate information on breakpoints and ask the right questions to determine whether customers might be eligible for breakpoints.

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18 *See* "Report of the Joint NASD/Industry Task Force on Breakpoints" at 1 (July 2003).

b. Developing standardized account information worksheets to assist firms in memorializing pertinent customer data for breakpoint eligibility.

c. Developing a written point-of-sale disclosure document explaining breakpoints to customers

2. In response to the written disclosure statement recommendation,[19] an industry working group developed a sample Written Disclosure Statement.[20] The Written Disclosure Statement addresses the following two areas regarding breakpoints:

3. The Written Disclosure Statement reviews Class A, B, and C shares and the types of sales charges they impose.

4. The Written Disclosure Statement explains that most mutual funds offer customers a variety of ways to qualify for breakpoint discounts on the sales charge for Class A shares and discusses these discounts. It also provides general information regarding Rights of Accumulation and Letters of Intent, though it notes that funds have different rules regarding their availability.

F. **SEC Requirements.** In 2004, the SEC adopted amendments to Form N-1A requiring mutual funds to provide enhanced disclosure regarding breakpoint discounts on front-end sales loads on June 7, 2004.[21] Under the amendments to Form N-1A, a mutual fund's prospectus must include: (1) information regarding eligibility qualifications for breakpoint discounts; (2) information regarding the methodology used by the fund sponsor to value accounts in determining eligibility; (3) a statement indicating that customers may need to provide additional account statements to an intermediary in order to receive the discounts; and (4) breakpoint information available on its website.

G. **Litigation.**

1. *Robert W. Baird & Co.*, FINRA News Release (February 18, 2009). FINRA has fined Robert W. Baird & Co. ("Baird") $50,000 for breakpoint violations and for violations related to its fee-based brokerage business. In particular, FINRA found that Baird failed to have a supervisory system in place to automatically credit certain customers with breakpoint discounts that were specified in new account agreements. As a result, 53 customers paid fees higher than those indicated on the Baird fee schedule, resulting in total overpayments of approximately $165,000.

2. *In the Matter of Suntrust Securities, Inc.*, 85 S.E.C. Docket 1219, 2005 WL 1172237 (May 17, 2005). The SEC, pursuant to a settlement, found that Suntrust Securities failed to provide all available breakpoint discounts even after the SEC

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19 See Report of the Joint NASD/Industry Task Force on Breakpoints, p. 13, Recommendation I.

20 *See* "Mutual Fund Breakpoint Discounts Disclosure Document" at http://www.finra.org/web/groups/industry/@ip/@issues/@bp/documents/industry/p010543.pdf.

21 Investment Company Act Release No. 26464 (June 7, 2004).

had alerted it to specific instances where it either failed to give a customer the appropriate breakpoint discounts or had sold customers mutual fund shares with front-end loads in amounts less than the breakpoint amount that would have entitled the customer to a lower sales charge. The SEC ordered disgorgement and prejudgment interest.

3. *H.D. Vest Inv. Sec., Inc.*, 82 S.E.C. Docket 424, 2004 WL 283431 (Feb. 12, 2004). The SEC, pursuant to a settlement, found that H.D. Vest Investment Securities, Inc. failed to apply applicable breakpoints, and improperly directed clients to Class B shares of the mutual fund that had higher commissions for amounts in excess of $100,000. The SEC imposed sanctions against the company.

4. *Wendell Belden*, 80 S.E.C. Docket 563, 2003 WL 21088079 (May 14, 2003). The SEC affirmed disciplinary sanctions imposed by FINRA against Wendell Belden for placing a client into Class B shares of mutual funds in order to obtain $52,000 in commissions. The client would have qualified for Class A share breakpoints.

5. *Prudential Sec. Inc.*, 80 S.E.C. Docket 1785, 2003 WL 21544428 (July 10, 2003). The SEC, pursuant to a settlement, found that Prudential Securities failed to supervise the improper sales of Class B shares of mutual funds to certain clients. The clients would have qualified for class A shares and more advantageous breakpoints. The brokerage firm had policies prohibiting such sales but did not have procedures in place to effectively monitor and enforce those policies.

6. *Fifteen Firms to Pay Over $21.5 Million in Penalties to Settle SEC and FINRA Breakpoints Charges*, S.E.C. Digest 2004-30-2, 2004 WL 283573 (Feb. 13, 2004). The SEC and FINRA brought enforcement and disciplinary actions against fifteen brokerage firms for failure to deliver mutual fund breakpoint discounts during 2001 and 2002. The firms agreed to compensate clients for the overcharges, pay fines totaling over $21 million, and undertake corrective measures.

7. *FINRA Action Against Oppenheimer & Co., and CEO.* On January 9, 2006, FINRA announced that it charged Oppenheimer & Co. and the firm's CEO, Albert Lowenthal, with knowingly submitting inaccurate and incomplete data in response to FINRA's request that the firm perform a self-assessment of its mutual fund breakpoint discount practices. In addition to the $1 million dollar fine, censure and independent consultant's review, Oppenheimer was obligated to conduct internal audits of its processes for intake, assignment and responses to regulatory inquiries. Oppenheimer was also required to report its findings to FINRA quarterly for a period of six quarters.

## III. **Sales of Class B Shares.**

A. Regulators and brokerage firms alike have over the recent past taken a close look at sales practices used in marketing so-called Class B shares of mutual funds. Owning Class B shares, which are typically sold subject to contingent deferred sales charge by a fund paying fees under a 12b-1 plan, may cause an investor in the fund, in some instances, to pay higher expenses than he or she would have, had he or she held shares of another class issued by the fund.

B. **SEC Enforcement Actions.**

1. *In the Matter of IFG Network Securities, Inc., et al.*, Investment Advisers Act Release No. 2147 (Jul. 15, 2003). The SEC instituted public proceedings against William I. Kissinger, Kissinger Advisory, Inc., Bert E. Miller, Glenn F. Wilkenson and David Ledbetter for allegedly defrauding customers by omitting material facts in connection with the sale of Class B shares of mutual funds. After a 22 day hearing, the Administrative Law Judge ("ALJ") dismissed all charges against the broker-dealer, its president and three registered representatives. The ALJ found, among other things, that it is unproven that Class A shares always outperform Class B shares at the $250,000 level. The ALJ also noted the SEC proposed rule making regarding Rule 12b-1 fees. The ALJ then concluded that in light of her finding regarding the relative performance of Class A versus Class B shares, and the rulemaking proceedings, none of the registered representatives violated the antifraud provisions in regard to disclosure about relative performance. The ALJ also refused to find that the registered representatives were required to disclose that they received higher commissions for selling Class B shares. Initial Decision Release No. 273 (February 10, 2005). The case was taken up on appeal, and oral argument before the SEC was held on November 15, 2005. On appeal, the Court found that the Division had not established that IFG Network Securities, Inc. and Ledbetter failed to exercise reasonable supervision with a view to preventing Kissinger's antifraud violations within the meaning of Section 15(b) of the Exchange Act. However, the Court did conclude that Kissinger's violations were sufficiently serious and recurrent to warrant imposition of a cease-and-desist order against him. He was also ordered to pay $36,170 in disgorgements together with prejudgment interest. Investment Advisers Act Release No. 2533 (Jul. 11, 2006).

2. *In the Matter of J. Michael Scarborough and Royal Alliance Associates*, Inc., Securities Exchange Act Release No. 33-8438, 83 S.E.C. Docket 742, 2004 WL 1531832 (July 8, 2004). The SEC, pursuant to a settlement, found that Scarborough, the branch office manager for Royal Alliance, through the registered representatives under his supervision, sold brokerage customers Class B mutual fund shares in amounts that would have entitled them to breakpoint discounts had they purchased Class A shares of the same funds. Scarborough, along with the registered representatives, disclosed the characteristics of Class A shares and Class B shares to customers, including a description of the discounts to which the customers would have been entitled, but did not tell them that Class A shares generally produce higher returns than Class B shares of the same mutual fund when purchased in amounts of $100,000 or more. The SEC found a failure to supervise on the part of both Royal Alliance and Scarborough. The SEC ordered Scarborough to pay disgorgement and prejudgment interest totaling over $2 million, coupled with a 30-day suspension. The SEC censured Royal Alliance.

3. *Morgan Stanley*. The SEC, pursuant to a settlement, found that Morgan Stanley failed to disclose adequately the higher fees associated with large ($100,000 or greater) purchases of Class B shares of certain of its proprietary mutual funds and that the fees could have a negative effect on clients' investment returns. The SEC's order noted that Morgan Stanley's sales force earned more compensation on sales

of Class B shares of Morgan Stanley funds than on sales of those funds' Class A shares, creating an incentive to place customers in Class B shares of funds. As part of its settlement, Morgan Stanley undertook to offer to convert certain Class B shares held in large amounts by those customers into Class A shares and take other remedial actions. In describing the SEC's settlement with Morgan Stanley, an SEC official said that: "[b]rokerage firms have a duty to ensure that the information they give their customers about different classes of mutual fund shares is complete and accurate, and that their recommendations are made for the benefit of customers, not themselves." SEC News Release (Nov. 17, 2003).

4. *In re Michael Flanagan et al.* Early in 2000, an Administrative Law Judge ("ALJ") found that registered representatives of a broker-dealer registered under the Exchange Act, as well as an investment firm registered under the Investment Advisers Act of 1940 ("Advisers Act"), violated certain antifraud provisions of the federal securities laws in connection with the sale of Class B shares of certain mutual funds.[22] The thrust of the SEC's allegations, which were upheld by the ALJ, was that the registered representatives and the adviser engaged in fraudulent activities under those laws by "steering their investors and clients to purchase Class B shares in various mutual funds, thus maximizing their own compensation and depriving their investors and clients of the discounts on sales charges that would have been applicable to their investments had [shares of another class of the funds] been purchased." *Id*. at 5-6. The ALJ rejected the claim of the representatives and the adviser that the investors and clients had received full disclosure of all important facts before they purchased the Class B shares. The SEC, however, found the ALJ's conclusions unpersuasive; on appeal, the SEC found that "the evidence does not support a finding of liability on the charges before us," and dismissed the action. *In re Michael Flanagan, Ronald Kindschi and Spectrum Administration, Inc.*, Advisers Act Release No. 2152 (July 30, 2003).

## C. **FINRA Actions.**

1. *MML Investors Services; NYLIFE Securities; Securities America.* On June 28, 2007, FINRA settled three cases against MML Investors Services, NYLIFE Securities, and Securities America for fines totaling over $1.1 million for failures relating to mutual fund sales practices. When recommending the purchase of mutual funds, FINRA stated that a member firm must assess the suitability of the class of shares to be purchased as well as the suitability of the particular fund. Primary considerations include the investment amount, the expected term of the investment, the applicable sales loads, fees and expenses associated with each class and the effect of such factors on the ultimate return on investment to the customer. FINRA found that, on certain occasions during January 2003 through July 2004, Securities America recommended and sold Class B and Class C share mutual funds and NYLIFE and MML recommended and sold Class B share mutual funds to their clients and did not adequately consider, on a consistent basis, the foregoing factors. These firms also had inadequate supervisory and compliance policies and procedures relating to these mutual fund sales.

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22 *In re Michael Flanagan et al.*, SEC Initial Dec. Release No. 160 (Jan. 31, 2000).

2. *Merrill Lynch; Wells Fargo; Linsco*. On December 19, 2005, FINRA announced that it fined Merrill Lynch, Pierce, Fenner & Smith, Wells Fargo Investments and Linsco/Private Ledger Corporation a total of $19.4 million for suitability and supervisory violations relating primarily to sales of Class B mutual fund shares as well as some Class C mutual fund shares. The amount of the fines approximate the additional commissions the firms received by selling Class B shares rather than Class A mutual fund shares. In addition, each firm was required to implement a remediation plan to compensate affected customers – collectively involving more than 29,000 households and nearly 140,000 transactions. FINRA alleged that between January 2002 and July 2003, the three firms recommended and sold Class B and/or Class C share mutual funds to their customers without considering or adequately disclosing on a consistent basis that an equal investment in Class A shares would generally have been more advantageous to those customers in view of all relevant considerations.

3. *Citigroup; American Express; Chase*. On March 23, 2005, FINRA announced that it censured and fined Citigroup Global Markets, Inc., American Express Financial Advisors and Chase Investment Services a total of $21.25 million for suitability and supervisory violations relating to mutual fund sales practices between January 2002 and July 2003. The cases against Citigroup and Chase involved their recommendations and sales of Class B and Class C shares of mutual funds, while the action involving American Express related only to Class B shares. In all three cases, the firms allegedly made recommendations and sales of mutual funds to their customers without considering or adequately disclosing, on a consistent basis, that an equal investment in Class A shares would generally have been more economically advantageous for their customers by providing a higher overall rate of return. In resolving these actions, the firms agreed to a remediation plan that includes over 50,000 households and more than 275,000 transactions in Class B shares, and to a lesser extent, Class C shares.

### D. **Private Actions.**

1. Firms have had to deal not only with regulators but also with suits filed by shareholders of their mutual funds. Morgan Stanley was named as a defendant in a class action suit alleging that its brokers repeatedly and inappropriately invested plaintiffs' assets in B share classes of Morgan Stanley's proprietary funds.[23] The plaintiffs argued that Morgan Stanley had a duty to disclose in the prospectus of the funds it manages that Class B shares, because of the fee structure, are "never the best choice for any rational investment strategy." The court found that Morgan Stanley's failure to include the specific information noted above did not make the prospectus false or misleading and Morgan Stanley, in fact, had no duty to make such an affirmative and conclusory statement. The court also stated that "[s]o long as [Morgan Stanley] provide[s] truthful information, then investors, with or without financial advisors, have the duty to decide what is 'best' for them." The dismissal was affirmed by the U.S. Court of Appeals for the Sixth Circuit on August 22, 2005.[24] In affirming the lower court, the

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23 *Edward Benzon v. Morgan Stanley*, No. 3:03-0159 (M.D. Tenn. Jan 8, 2004).

24 *Benzon*, 420 F.3d 598.

Sixth Circuit held, "Given that all of the information necessary to compare the different class shares was in the prospectuses…the alleged omissions in this case are not material." The Sixth Circuit also rejected the claim that the defendants violated the securities laws by not disclosing that the broker compensation structure favored the sale of Class B shares.

E. **Industry Response.**

1. In what appears to be, at least in part, a response to perceived regulatory and litigation pressures, a number of major financial services firms have in the recent past increasingly restricted sales of Class B shares by their registered representatives. Some firms have, for example, capped the amount their representatives can arrange for clients to invest in Class B shares or required a supervisor's permission for large sales of Class B shares. Chris Frankie, *American Tweaks B Shares, Others Sure to Follow*, Ignites (Dec. 15, 2004). In some cases, the representative must show that the transaction is economically appropriate for the client. *See, e.g.*, Dan Jamieson, *Firms Tighten Up On Fund Sales*, On Wall Street (Dec. 1, 2003). An increasing number of firms, including Franklin, have also decided to forego continuing Class B shares or not offer Class B shares in new funds. *See, e.g.*, Tom Leswing, *More Firms Scrapping B Shares*, Ignites (Mar. 11, 2004). These restrictions have produced immediate results, with Financial Research Corporation reporting that for the first ten months of 2004, Class A shares gained $47 billion in assets, while $41 billion in assets flowed out of Class B Shares. *Franklin to Drop B-Share Sales*, Ignites (Dec. 13, 2004).

2. Similar limitations on sales of Class C shares, which like Class B shares usually do not charge an up-front fee, but instead usually charge a higher 12b-1 fee, have recently been adopted by some fund companies, including Merrill Lynch and Wachovia. Tom Leswing, *Merrill Puts the Brakes on C-Share Sales*, Ignites (Dec. 22, 2004). Because of the size and stature of the firms, other fund companies may soon follow with Class C share sales restrictions of their own.

F. **Switches, Exchanges, and Replacements.**

1. **FINRA Guidance.** According to FINRA, a brokerage firm is obligated to evaluate the net investment advantage to a customer of any recommended switch from one mutual fund to another.[25]

a. **Requirements.** Although mutual fund switches are not per se unsuitable, they may be hard to justify switching a customer from one fund type to another if the associated sales load or transaction fee would undermine the financial gain or investment objective sought by the switch.

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25 FINRA Notice to Members 95-80 (September 26, 2995); FINRA Notice to Members 94-16 (May 25, 1994).

b. **No Transaction Fees.** A recommendation to a customer to switch funds should be made, if at all, for transactions within a single family where there are virtually no transaction costs associated with trading.

c. **Supervision.** A firm must have proper supervisory and compliance procedures to monitor switching of customers among funds, and such firm should maintain proper documentation supporting the decision to switch.

d. **Enforcement.** FINRA and the SEC have sanctioned broker-dealers for inappropriately or excessively "switching" or "churning" customer accounts among mutual funds.[26]

(i) *In the matter of Krull v. SEC.* (35 SEC 1011 (1998)). FINRA brought action against Kenneth C. Krull for violating FINRA's Rules of Fair Practice regarding unsuitable switches in mutual fund investments. Specifically, FINRA alleged that from November 1990 through July 1993, Krull repeatedly switched eight customers, holding ten accounts, in an out of a series of common stock mutual funds. Although each customer consented to the transactions, Krull failed to follow company policy to keep such activities to a minimum. The action was upheld by the SEC and by the 9th Circuit Court of Appeals.

(ii) *In the Matter of the Application of Charles E. Marland & Co., Inc.* (45 SEC 632 (October 21, 1974)). FINRA alleged that Charles Marland, the company's president, and Harold Monson and C. Clyde Allison, former registered representatives, violated FINRA's rules of fair practice by improperly inducing liquidations by customers of mutual fund shares and the reinvestment of the proceeds in other similar funds. FINRA found that during the period from 1967 through August 1970, 61 switches in mutual fund shares were effected in 52 of the firm's customer accounts, all of which required payment of sales loads.

2. **Recent Developments Relating to Cash Sweep Programs Involving Money Market Mutual Funds.**

a. In a sweep program, a broker-dealer transfers (or "sweeps") a customer's free credit balances into a specific money market mutual fund or interest bearing bank account. The customer earns dividends on the money market mutual fund or interest on the bank account until such time as the customer chooses to liquidate the position in order to use the cash, for example to purchase securities.

b. Broker-dealers wishing to switch customers from a money market mutual fund to a bank sweep generally are required either to obtain each customer's affirmative consent to the switch or effect the switch using a "drain and fill" model in which all sweep deposits are made to the bank account and all sweep

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26 *See, e.g.,* FINRA District No. 3 Business Conduct Committee v. Stephen Alan Roche (May 11, 1992); FINRA District No 13 Business Conduct Committee v. Michael A. Barbala to (June 17, 1991).

withdrawals are made from the money market mutual fund. When a customer's money market mutual fund position is fully liquidated, all subsequent deposits and withdrawals are made to and from the bank account.[27]

c. The ability of a broker-dealer to switch customers from one sweep option to another is largely governed by FINRA's rules governing discretionary accounts (*i.e.*, NASD Rule 2510.) Additionally, the SEC has addressed the issue in a 2007 proposal to amend its financial responsibility rules, although that proposal, to date, has not been adopted.[28]

d. **Requirements under FINRA Rules.**

(i) **NASD Rule 2510.** NASD Rule 2510(b) generally requires member firms to obtain written authorization from a customer prior to exercising discretionary power in the customer's account. A broker-dealer is considered to be exercising discretionary power if it liquidates a customer's position in a money market mutual fund in order to switch the customer into another sweep vehicle.

(ii) **Exception for Bulk Exchanges of Money Market Mutual Funds.** NASD Rule 2510(d)(2) provides an exception from the authorization requirement for certain transactions involving bulk exchanges of money market mutual funds. Specifically, Rule 2510(d)(2) states that bulk exchanges at net asset value of money market mutual funds may be carried out using negative response letters provided:

(A) The bulk exchange is limited to situations involving mergers and acquisitions of funds, changes of clearing members and exchanges of funds used in sweep accounts;

(B) The negative response letter contains a tabular comparison of the nature and amount of the fees charged by each fund;

(C) The negative response letter contains a comparative description of the investment objectives of each fund and a prospectus of the fund to be purchased; and

(D) The negative response feature will not be activated until at least 30 days after the date on which the letter was mailed.

(iii) **FINRA Staff Guidance.** The FINRA staff has previously issued guidance and interpretive relief regarding the application of Rule 2510 to sweep programs.

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27 *See* FINRA's NASD Rule 2510 and discussion *infra.*

28 Securities Exchange Act Release No. 55431 (March , 2007), 72 FR 12862 ("Financial Responsibility Proposal").

(A) *Letter re: MetLife Securities, Inc. (February 3, 2003).* In a letter to MetLife Securities, Inc. ("MetLife"), the FINRA staff clarified that, when switching customers from a money market mutual fund sweep product to a bank sweep product, a broker-dealer may not avail itself of the exception under Rule 2510(d)(2) for bulk transfers. The FINRA staff stated that, in those cases, an exchange of money market mutual funds at net asset value would not include the transfer of funds from a money market mutual fund to a bank account.

(B) *Letter re: Mesirow Financial, Inc. (January 26, 2005).* In a letter to Mesirow Financial, Inc. ("Mesirow"), the FINRA staff concluded that Mesirow could use the negative response process under Rule 2510(d)(2) where the money market mutual fund Mesirow was using as its sweep product had been liquidated and the funds returned to Mesirow, where they were being held as free credit balances. The FINRA staff concluded that Rule 2510(d)(2) was applicable even where the proceeds from the liquidated fund had been held as free credit balances for an intervening period before being reinvested in the replacement money market mutual fund.

(C) *FINRA Staff Interpretive Memo (May 15, 2008).* In a Staff Interpretive Memo, FINRA staff considered the applicability of Rule 2510(d)(2) where a money market mutual fund designated as a sweep vehicle indicates that it may refuse or limit additional share purchases. FINRA staff concluded that, where a money market mutual fund announces with inadequate notice that it will close or limit new share purchases, a broker-dealer may select and activate an alternative money market mutual fund as a sweep vehicle without waiting for the 30-day negative consent period under Rule 2510(d)(2)(D), provided that the broker-dealer must:

(1) Use best efforts to seek a new sweep money market mutual fund that is an appropriate money market mutual fund for customers, considering such factors as yield, fees, investment objectives, risks and current market conditions;

(2) Establish instructions to sweep customer cash balances into newly designated money market mutual funds;

(3) Promptly notify customers using negative response letters of the change in sweep funds and include in such written notification the disclosures to customers as required by Rule 2510(d)(2)(B) and (C); and

(4) State in the written notification that customers may give instructions to invest in available alternatives to a newly designated money market sweep fund (for example, another money market mutual fund that may not be part of the member's sweep program).

(iv) **FINRA Guidance on the Reserve Funds.** In September 2008, FINRA issued a regulatory notice specifically addressing the Reserve Funds that had failed to maintain a $1.00 net asset value. FINRA's Regulatory Notice 08-48 provided that broker-dealers could effect bulk exchanges of customer assets

invested in the Reserve Funds to another money market mutual fund or an FDIC-insured bank account without compliance with all of the provisions of Rule 2510(d)(2), subject to the following conditions:

(A) The broker-dealer must ensure that the money market mutual fund or bank deposit account into which it is moving customer assets is suitable for each customer based on the requirements of FINRA's NASD Rule 2310; and

(B) The broker-dealer must notify customers in writing promptly after the exchange. If customers' assets are moved into a new money market mutual fund, the notice must include the tabular comparison of the nature and amount of fees charged by each fund as required by Rule 2510(d)(2)(B) and the comparative description of the investment objectives of each fund and a prospectus of the new money market mutual fund as required by Rule 2510(d)(2)(C). If customers' assets are being moved into an FDIC-insured bank account, the notice must include a description of the account, any fees associated with the account, and a listing of the account's terms and conditions that the bank normally provides to customers opening such an account.

e. **SEC Financial Responsibility Proposal.**

(i) In its 2007 Financial Responsibility Proposal, the SEC proposed specific requirements regarding a broker-dealer's ability to transfer customers' free credit balances to money market mutual funds or to bank accounts. The SEC's proposal addressed sweeps for new accounts and for existing accounts.

(ii) **Sweeps for New Customers.** The SEC's proposal would permit a broker-dealer to have the ability to change the sweep option of a new customer (*i.e.*, a customer whose account is opened on or after the effective date of the proposed rule) from a money market mutual fund to a bank deposit account (and vice versa), provided certain specific conditions are met.

(A) First, the customer would have to agree prior to the change (*e.g.*, in the account opening agreement) that the broker-dealer could switch the sweep option between those two types of products.

(B) Second, the broker-dealer would have to provide the customer with all notices and disclosures regarding the investment and deposit of free credit balances required by the self-regulatory organizations of which the broker-dealer is a member.[29]

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29 *See, e.g.*, NYSE Information Memo 05-11 (February 15, 2005) ("IM 05-11"). In IM 05-11, NYSE addressed the disclosure responsibilities of a broker-dealer offering a bank sweep program to its investors. IM 05-11 stated that broker-dealers should disclose material differences in interest rates between the different products and, with respect to the bank sweep program, the terms and conditions, risks and features, conflicts of interest, current interest rates, the manner by which future interest rates will be determined, and the nature and extent of FDIC and SIPC protection.

(C) Third, the broker-dealer would have to provide the customer with notice in the customer's quarterly statement that the money market mutual fund or bank deposit account can be liquidated on the customer's demand and converted back into free credit balances held in the customer's securities account.

(D) Fourth, the broker-dealer would have to provide the customer with notice at least 30 calendar days before changing the product (*e.g.*, from one money market mutual fund to another), the product type (*e.g.*, from a money market mutual fund to a bank account), or the terms and conditions under which the free credit balances are swept. The notice would have to describe the change and explain how the customer could opt out of it.

(iii) **Sweeps for Existing Customers.** The SEC's proposal would permit a broker-dealer to have the option to change a sweep option for an existing customer (*i.e.*, a customer whose account was opened as of the effective date of the proposed rule) from a money market mutual fund to a bank deposit account (and vice versa), provided the second, third, and fourth conditions described above were met. The SEC stated that, to avoid the necessity of having to amend each existing customer agreement, the provisions of the proposed rule regarding existing customers would not require the broker-dealer to obtain the customer's previous agreement to permit the broker-dealer to switch the sweep option between money market mutual fund products and bank deposit account products.

f. To date, the SEC has not taken final action on the Financial Responsibility Proposal, so these requirements have not come into effect.

## IV. Treasury Guarantee Program for Money Market Mutual Funds

A. On September 29, 2008, the U.S. Treasury Department ("Treasury") announced a Temporary Guarantee Program for Money Market Funds (the "Guarantee Program"). All money market mutual funds that are regulated under Rule 2a-7 under the 1940 Act, maintain a stable share price of $1.00, and are publicly offered and registered with the SEC are eligible for the Guarantee Program.

B. Eligible money market mutual funds initially were required to apply for the Guarantee Program by October 8, 2008, and the Guarantee Program originally was scheduled to remain effective until December 18, 2008. Subsequently, Treasury extended the Guarantee Program to April 30, 2009, and money market mutual funds were required to apply for the extended Guarantee Program by December 5, 2008. Treasury is authorized to extend the program until September 19, 2009, but no decision has been made as to whether to extend the program past April 30, 2009.

C. The Guarantee Program guarantees the payment to investors of participating money market mutual funds if (1) the net asset value ("NAV") of the money market mutual fund falls below $1.00 and (2) the money fund liquidates. The coverage amounts are based on the number of shares a shareholder of record held as of the close of business September 19, 2008.

D. In effect, the coverage amount for a shareholder will be the lesser of: (1) the number of shares owned on September 19, 2008; or (2) the number of shares owned on the first date after September 19, 2008 on which the market-based NAV of the participating money fund is less than $0.995 ("Guarantee Event"). These coverage limits apply regardless of whether a shareholder has made additional investments in the participating money fund or withdrawn assets from the participating money fund between September 19, 2008 and the Guarantee Event.

E. Under the Guarantee Program, covered shareholders will receive $1.00 per covered share upon liquidation of an eligible money market mutual fund, subject to the aggregate $50 billion in coverage available to all participating money funds under the program.

F. **FINRA Guidance to Broker-Dealers on the Guarantee Program.**

1. In October 2008, FINRA issued Regulatory Notice 08-58 to provide broker-dealers with guidance on the Guarantee Program. In particular, FINRA stated that communications to customers that mention the Guarantee Program must describe its scope and limitations accurately, as well as its temporary nature.

2. FINRA stated that, under NASD Rule 2210, and based upon its discussions with the SEC and Treasury staffs, FINRA expects member firm communications that discuss the Guarantee Program to provide in substance the following information:

a. The Guarantee Program provides a guarantee to participating money market mutual fund shareholders based on the number of shares invested in the fund at the close of business on September 19, 2008.

b. Any increase in the number of shares an investor holds after the close of business on September 19, 2008, will not be guaranteed.

c. If a customer closes his/her account with a fund or broker-dealer, any future investment in the fund will not be guaranteed.

d. If the number of shares an investor holds fluctuates over the period, the investor will be covered for either the number of shares held as of the close of business on September 19, 2008, or the current amount, whichever is less.

e. The Program expires on April 30, 2009, unless extended by Treasury.