

NASD Notice to Members 98-98

SEC Approves Rule Change Relating To Mutual Fund Breakpoint Sales

Suggested Routing

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Executive Summary

On November 10, 1998, the Securities and Exchange Commission (SEC) approved amendments to the National Association of Securities Dealers, Inc. (NASD[®]) Interpretive Memorandum 2830-1 (IM-2830-1) to clarify the application of the mutual fund breakpoint sales rule to modern portfolio investment strategies. The amendments are effective immediately.

Questions regarding this *Notice* may be directed to Joseph E. Price, Director, Corporate Financing, NASD Regulation, Inc. (NASD RegulationSM), at (202) 728-8877, or Robert J. Smith, Assistant General Counsel, Office of General Counsel, NASD Regulation, at (202) 728-8176.

Discussion

In the context of mutual fund sales, a "breakpoint" is that point at which the sales charge is reduced for quantity purchases of fund shares. NASD Rule IM-2830-1 prohibits sales of mutual fund shares in amounts below breakpoints, if such sales are made "so as to share in higher sales charges." The application of this standard depends on the purpose, or intent, of the member recommending the transaction. Accordingly, whether a breakpoint sales violation has occurred must depend on facts and circumstances that provide evidence of intent.

Recently, NASD Regulation considered the application of IM-2830-1 to modern portfolio investment strategies that utilize many different mutual funds with varying investment objectives. The amendments specify more precisely those facts and circumstances the staff will consider when examining whether trades that miss breakpoints, but are made pursuant to bona fide asset allocation programs, may have violated NASD rules.

NASD Regulation believes that, under most circumstances, sales under a breakpoint pursuant to a bona fide asset allocation program would not constitute a breakpoint violation. Because investors generally can benefit from asset-based investment strategies, such strategies should not be discouraged. The amendments provide that, for purposes of determining whether a sale was made in a dollar amount below a breakpoint in order to share in a higher commission, the NASD will consider the facts and circumstances of the sale, including whether the member has retained records that demonstrate that the trade was executed in accordance with a bona fide asset allocation program and that customers were informed that they may not receive breakpoint reductions that otherwise would be available.

Text Of Amendments

(Note: New text is underlined.)

IM-2830-1 "Breakpoint" Sales

The sale of investment company shares in dollar amounts just below the point at which the sales charge is reduced on quantity transactions so as to share in the higher sales charges applicable on sales below the breakpoint is contrary to just and equitable principles of trade.

Investment company underwriters and sponsors, as well as dealers, have a definite responsibility in such matters and failure to discourage and to discontinue such practices shall not be countenanced.

For purposes of determining whether a sale in dollar amounts just below a breakpoint was made in order to share in a higher sales charge, the Association will consider the facts and circumstances, including, for example, whether a member has retained records that demonstrate

that the trade was executed in accordance with a bona fide asset allocation program that the member offers to its customers:

- which is designed to meet their

diversification needs and investment goals; and

- under which the member discloses to its customers that they may not

qualify for breakpoint reductions that are otherwise available.

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