

Notice to Members

MARCH 2004

SUGGESTED ROUTING

Legal and Compliance
Operations
Senior Management

KEY TOPICS

Breakpoints
Unit Investment Trust Sales

GUIDANCE

Unit Investment Trust Sales

NASD Reminds Members of Their Duty to Ensure Proper Application of Discounts in Sales Charges to Sales of Unit Investment Trusts (UITs)

Executive Summary

Unit Investment Trusts (UITs) that charge initial sales charges sometimes offer discounts in the sales charge based on the dollar amount or number of units of the investment. The thresholds at which the discounts are offered in the sale of UITs generally are called price breaks, and are substantially similar to breakpoint discounts in the sale of mutual fund shares. Because breakpoint discounts are widespread in the sale of front-load Class A mutual funds, NASD recently has taken a number of steps to ensure that members understand, inform customers about, and correctly apply breakpoint discounts in the sale of mutual fund shares. The purpose of this *Notice* is to remind members that the same duties extend to the sale of UITs that offer price breaks, and that they should develop and implement the same type of procedures for ensuring the proper application of such discounts in connection with the sale of UITs as they have in connection with the sale of mutual funds.

Questions/Further Information

Questions or comments concerning this *Notice* may be directed to Marc Menchel, Executive Vice President and General Counsel, Regulatory Policy and Oversight, at (202) 728-8071.

Discussion

Mutual funds that charge front-end sales charges often offer discounts in the sales charge based on the dollar amount of an investment. For example, a mutual fund may charge a sales charge of 5.75 percent for purchases of less than \$50,000; reduce the charge to 4.50 percent for aggregate purchases over that amount; reduce it again for aggregate purchases over \$100,000; and further reduce it or eliminate it entirely for still higher purchases. In the sale of mutual funds, the dollar thresholds at which the discounts are offered are generally called breakpoints. Breakpoints are set by the mutual fund company in the fund's prospectus, and vary from fund to fund. Investors may be eligible for breakpoint discounts based on a single transaction that meets a dollar threshold. In addition, depending on the terms of the prospectus, investors may be entitled to a discount for aggregate purchases by using a letter of intent (LOI) or based on rights of accumulation (ROA). It is the responsibility of firms and their employees selling mutual fund shares to review and understand the terms of the prospectus, and to ensure that customers are aware of and receive applicable breakpoint discounts.

NASD recently has taken several steps to ensure that firms are fulfilling that responsibility. In December 2002, NASD issued *Special Notice to Members 02-85*, which reminded members that they must: (a) understand the breakpoint discounts offered by mutual funds; (b) determine what information should be recorded on their books and records to allow them to provide all available discounts; (c) inform each customer of relevant discount opportunities; and (d) correctly process the transaction so that the customer receives any applicable discount. Subsequently, at the request of the SEC, NASD convened and led a Joint NASD/Industry Breakpoint Task Force (Joint Task Force) to develop recommended practices that would facilitate the complete and accurate delivery of breakpoint discounts. The Joint Task Force released its report in July 2003, *Report of the Joint NASD/Industry Task Force on Breakpoints*, available on NASD's Web Site at www.nasdr.com/breakpoints_report.asp. Among other things, the Joint Task Force recommended that firms develop procedures for: training employees about breakpoint discounts; informing customers about what breakpoints apply to products in which they are planning to invest; and correctly processing applicable breakpoint discounts. NASD has developed a range of training materials and forms for firms to use in implementing these recommendations, which can be found on NASD's Web Site at www.nasdr.com/breakpoints_members.asp.

UITs are investment companies that offer redeemable shares, or units, of a generally fixed portfolio of securities in a one-time public offering, and terminate on a specified date. Like mutual funds, some UITs that charge initial sales charges offer discounts in the sales charge based on the dollar amount or number of units of the investment, although in the context of UITs such discounts generally are called price breaks rather than breakpoints. For example, a UIT may charge an initial sales charge of 1.00 percent

for purchases of less than 50,000 units; reduce the charge to .75 percent for purchases of between 50,000 and 100,000 units; reduce it again to .25 percent for purchases of between 100,000 and 250,000 units; and eliminate it entirely for purchases of more than 250,000 units. As in the case of mutual fund shares, investors may be eligible for discounts based on a single transaction. There may also be limited rights of accumulation, depending on the terms and conditions set forth in the prospectus.

The purpose of this *Notice* is to remind members that they have the same duty to understand, inform customers about, and correctly apply price breaks in the sale of UITs that they have with regard to breakpoint discounts in the sale of Class A mutual fund shares, and that they should develop and implement the same type of procedures for ensuring the proper application of such discounts in connection with the sale of UITs that they have in connection with the sale of mutual funds. Although many of the recommendations of the Joint Task Force, as well as the training materials and forms developed by NASD in response to those recommendations, are specific to mutual funds, NASD suggests that firms look to both sources for guidance in devising appropriate procedures with respect to the sale of UITs.

Conclusion

NASD considers it essential that sales of UITs be affected on the most advantageous terms available to the customer. It is the responsibility of firms to take appropriate steps to ensure that they and their employees understand, inform customers about, and apply correctly any applicable price breaks available to customers in connection with UITs. Furthermore, the principles underlying this *Notice* and *Special Notice to Members 02-85* are the same: a member has a duty to train employees, inform customers, and correctly process every transaction in a manner that promotes and ensures delivery of all promised commercial terms of an investment or product, including any applicable discounts to pricing, commissions, fees, or spreads. Failure to take such steps may constitute a violation of NASD rules.