

**MEMO# 13856**

August 15, 2001

# **INSTITUTE COMMENT LETTER ON NASDR PROPOSAL ON REQUIRED DISCLOSURES FOR SECURITIES RECOMMENDATIONS**

[13856] August 15, 2001 TO: SEC RULES COMMITTEE No. 66-01 ADVERTISING COMPLIANCE ADVISORY COMMITTEE No. 13-01 INVESTMENT ADVISERS COMMITTEE No. 20-01 RE: INSTITUTE COMMENT LETTER ON NASDR PROPOSAL ON REQUIRED DISCLOSURES FOR SECURITIES RECOMMENDATIONS The Institute has filed a comment letter (attached) with NASD Regulation on its request for comment on proposed amendments to NASD Rule 2210, Communications with the Public.<sup>1</sup> In particular, the proposed amendments would increase the disclosures required when an NASD member recommends a security in written advertisements and sales literature and would require similar disclosures for recommendations made by an associated person during a “public appearance.” I.

**Application of Proposal to Investment Advisory Personnel** The comment letter states that the Institute strongly opposes the application of the proposed rule change to investment advisory personnel. First, the letter states that as a general matter, the Institute believes the proper context for any new requirements on such persons is rulemaking by the Securities and Exchange Commission under the Investment Advisers Act of 1940 and/or the Investment Company Act of 1940. In addition, the letter states that the proposal does not consider the differences in the potential conflicts of interest presented by “sellside” analyst recommendations and statements made by investment advisory personnel and, as such, the proposal fails to recognize that, at least in the great majority of cases, any potential conflicts of interest for such persons would be greatly attenuated. The comment letter also notes that NASDR failed to take into account the fact that advisory firms already have stringent procedures in place to address potential conflicts relating to the personal investment activities of investment advisory personnel. For these reasons, the letter states that NASDR should not seek to regulate the activities of investment advisory personnel under this proposal. However, the letter states that if NASDR determines that such persons should be subject to the proposal, it should, in recognition of the differences in the degree of potential conflicts of interest, revise the proposed disclosure 1 NASD Notice to Members 01-45 (July 2001). 2 requirements as they would apply to such individuals to reflect these differences. In particular, the letter states that NASDR should require the disclosure of financial interests in a recommended security held in a discretionary account managed by an associated person only when those financial interests comprise over five percent of the account’s portfolio holdings as this would appropriately limit the disclosure to those instances where the holdings might be viewed as significant enough to materially impact the fund’s or account’s performance. In addition, the letter recommends that NASDR should not require the disclosure of the specific funds and/or discretionary accounts managed by an associated person that have a financial interest in a recommended security, but instead

should only require a general statement about the financial interest. II. Scope and Use of the Term “Recommendation” The letter also makes several comments regarding the scope and use of the term “recommendation.” In particular, the letter notes that although the disclosure requirements under the proposal would be triggered whenever there is a “recommendation,” NASDR has not defined this term for these purposes. The letter therefore states that this term should be interpreted in a manner that is consistent with how NASDR has defined it in the past, and strongly urges NASDR to clarify this prior to adoption of the proposal. Specifically, the letter states that NASDR should clarify that a favorable comment by a portfolio manager during a public appearance regarding a security that is part of his fund’s portfolio holdings would not be considered a “recommendation” of that security for purposes of the proposal as such a statement would not, at least by itself, be designed to promote transactions by individual investors in the particular security. In addition, the letter states that it is the Institute’s understanding that NASDR has informally taken the position that disclosure of certain holdings of a mutual fund (or unit investment trust) in an advertisement or sales literature does not constitute a recommendation of those particular securities and requests clarification that NASDR will continue to take this position. If, however, because of increased concerns in this area, NASDR intends the proposal to cover communications beyond those that have been traditionally considered recommendations, the letter states that it is extremely important that NASDR revise the proposal and use a term other than “recommendation” to refer to those communications. Otherwise, there will be substantial confusion regarding the scope of other NASDR rules and guidance that employ that term. III. Requested Clarifications The letter states that if the final rule does apply to portfolio managers, NASDR should clarify its application in the case of mutual funds or other discretionary accounts with more than one portfolio manager. Specifically, in the case of a multi-manager fund, the letter states that a portfolio manager should only be required to disclose information pertaining to that portion of the fund over which he has discretion. In addition, the Institute recommends that the proposal be modified to expressly clarify that ownership of a recommended security through a mutual fund (or other investment company) by an individual covered by the rule does not constitute a “financial interest” in a security that would have to be disclosed under the rule. The letter states that requiring NASD members and associated persons to look through a mutual fund to determine if the fund holds a recommended security would result in significant difficulties in complying with the rule. Ari Burstein Associate Counsel Attachment Attachment (in .pdf format)