

MEMO# 10522

December 1, 1998

INSTITUTE COMMENT LETTER ON NASD BOND FUND VOLATILITY RATINGS PROPOSAL

1 See Memorandum to Advertising Compliance Subcommittee No. 44-98, SEC Rules Committee No. 113-98 and Unit Investment Trust Committee No. 34-98, dated November 10, 1998. 2 See Memorandum to Advertising Compliance Subcommittee No. 47-98, SEC Rules Committee No. 118-98 and Unit Investment Trust Committee No. 36-98, dated November 18, 1998. [10522] December 1, 1998 TO: ADVERTISING COMPLIANCE SUBCOMMITTEE No. 49-98 SEC RULES COMMITTEE No. 123-98 UNIT INVESTMENT TRUST COMMITTEE No. 38-98 RE: INSTITUTE COMMENT LETTER ON NASD BOND FUND VOLATILITY RATINGS PROPOSAL

The Institute recently filed with the Securities and Exchange Commission the attached comment letter on proposed changes to the National Association of Securities Dealers, Inc. rules that would permit, on an interim 18-month basis, brokerage firms to use bond fund volatility ratings in supplemental sales literature.¹ The letter has been modified somewhat from, but generally presents the same arguments as, the draft circulated on November 18.² The letter states that the proposal addresses many, but not all, of the ICI's concerns about the use of "risk" ratings. The letter expresses general support for the proposal, subject to the proposal not being modified in any way that would weaken its investor protection provisions. In addition, the Institute's support is conditioned on the NASD undertaking a comprehensive review of the proposal at the end of the 18-month pilot period before determining whether to allow volatility ratings in supplemental sales literature on a permanent basis. The letter supports many of the conditions contained in the proposal, including the requirements that ratings be based exclusively on objective, quantifiable factors, and that ratings not be designated by a single symbol, letter or number. The letter also supports the requirement that ratings be current as of the most recent calendar quarter end as well as the proposal's disclosure requirements. The letter argues that the proposal should be modified, however, to prohibit the use of ratings that have been requested and paid for by a rated fund, since such arrangements present significant conflicts of interest. We would appreciate receiving copies of any letters filed on this proposal by your firms. Joseph P. Savage Associate Counsel Attachment

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