

**MEMO# 11717**

March 10, 2000

## **SEC APPROVES NASD RULE CHANGE TO PERMIT BOND MUTUAL FUND VOLATILITY RATINGS ON A TEMPORARY BASIS**

1 SEC Release No. 34-42476 (Feb. 29, 2000), 65 Fed. Reg. 12305 (March 8, 2000). 2 See SEC Release No. 34-40627 (Nov. 2, 1998), 63 Fed. Reg. 60431 (Nov. 9, 1998). See also, Memorandum to Advertising Compliance Subcommittee No. 44-98, SEC Rules Committee No. 113-98, and Unit Investment Trust Committee No. 34-98, dated Nov. 10, 1998. 3 See Letter from Craig S. Tyle, General Counsel, ICI to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated Nov. 30, 1998. See also, Memorandum to Advertising Compliance Subcommittee No. 49-98, SEC Rules Committee No. 123-98, and Unit Investment Trust Committee No. 38-98, dated Dec. 1, 1998. 1 [11717] March 10, 2000 TO: ADVERTISING COMPLIANCE ADVISORY COMMITTEE No. 9-00 SEC RULES COMMITTEE No. 39-00 UNIT INVESTMENT TRUST COMMITTEE No. 9-00 RE: SEC APPROVES NASD RULE CHANGE TO PERMIT BOND MUTUAL FUND VOLATILITY RATINGS ON A TEMPORARY BASIS

The Securities and Exchange Commission recently approved changes to National Association of Securities Dealers, Inc. Rule 2210 to permit the use of bond mutual fund volatility ratings in supplemental sales literature for an 18-month trial period. The pilot program is effective immediately and expires on August 31, 2001. A copy of the SEC release is attached and summarized below.<sup>1</sup> In November 1998, the SEC published for comment proposed changes to NASD Rule 2210 that would permit members and associated persons to include bond fund volatility ratings in supplemental sales literature on an interim 18-month basis, subject to certain conditions.<sup>2</sup> In particular, the proposed pilot program required that volatility ratings must be based on objective factors, must be in narrative form and cannot be designated by the use of a single symbol, number or letter, must meet timeliness standards, and must be accompanied by clear, comprehensive disclosures. The Institute submitted a comment letter expressing serious reservations about the use of volatility ratings due to their potential to mislead investors, but nonetheless generally supporting the pilot program based on the above proposed restrictions on their use.<sup>3</sup> Most of the safeguard conditions on the use of volatility ratings, which the Institute supported, remain in the approved pilot program. Additionally, as the Institute supported in earlier versions of the proposed rule change, the volatility ratings may be issued by any independent third party, not just NRSROs. The pilot program, however, does not prohibit the payment for the ratings by the funds being rated, notwithstanding the recommendation of the Institute and other commenters that, due to the inherent conflicts of interest such payment

arrangements present, they should not be permitted. 4 The release also clarifies that volatility ratings can be based only on objective factors and that the pilot program only applies to open-end investment companies. 2 The pilot program approved by the SEC differs in one significant respect from the one proposed. The prohibition against the use of a single symbol, number or letter to describe the volatility rating has been eliminated. The SEC's rationale for this change is that it will "provide agencies with more flexibility in how the ratings are presented." The release notes that several commenters (including the ICI) "suggested that investors were more likely to rely on ratings conveyed in the form of a number or symbol without fully understanding their meaning or significance." Nevertheless, the SEC stated that the requirement to provide a narrative description of the rating along with a number or symbol, together with certain required disclosures "should decrease the likelihood of investor confusion concerning a rating's meaning."4 The SEC is soliciting comment on the removal of the prohibition against the use of a single symbol, number or letter to describe the ratings. Comments are due to the SEC by March 29, 2000. If you have any comments you would like to be considered for inclusion in the Institute's comment letter, please contact Dore Zornada (phone: 202/326-5819, fax: 202/326-5839, email: [dvanslyke@ici.org](mailto:dvanslyke@ici.org)) or Amy Lancellotta (phone: 202/326-5824, fax: 202/326-5827, or email: [amy@ici.org](mailto:amy@ici.org)) no later than Wednesday, March 22. Doretha VanSlyke Zornada Assistant Counsel Attachment

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