

MEMO# 9427

November 19, 1997

NASDR STATEMENT ON BOND FUND RATINGS

* As you may recall, NASDR issued a Notice to Members last year soliciting comment on the use of bond fund risk ratings in supplemental sales literature. In particular, NASDR solicited comment on whether it should continue to prohibit the use of these ratings. See Memorandum to Board of Governors No. 67-96, Advertising Subcommittee No. 37-96 and SEC Rules Members No. 86-96, dated December 31, 1996, and Memorandum to Unit Investment Trust Committee No. 6-97, dated February 7, 1997. The Institute submitted to NASDR a comment letter and a supplemental comment letter opposing the use of risk ratings as proposed by the rating agencies. See Memorandum to Board of Governors No. 10-97, Advertising Subcommittee No. 9-97, SEC Rules Committee No. 21-97 and Unit Investment Trust Committee No. 11-97, dated February 25, 1997 (transmitting the ICIs initial comment letter), and Memorandum to Board of Governors No. 53-97, Advertising Subcommittee No. 32-97, SEC Rules Committee No. 90-97 and Unit Investment Trust Committee No. 56-97, dated September 16, 1997 (transmitting the ICIs supplemental comment letter). [9427] November 19, 1997 TO: BOARD OF GOVERNORS No. 63-97 ADVERTISING SUBCOMMITTEE No. 39-97 SEC RULES COMMITTEE No. 111-97 UNIT INVESTMENT TRUST COMMITTEE No. 67-97 RE: NASDR STATEMENT ON BOND FUND RATINGS _____ Last

week, the NASD Regulation, Inc. (NASDR) Board of Directors approved a proposed rule that would establish an 18-month pilot program allowing the use of bond fund "volatility ratings" in supplemental sales material.* During this trial period, NASDR will collect data from the rating agencies, fund groups and brokerage firms to assess the programs effect. The proposed rule will be submitted shortly to the NASD Board of Governors for approval. The proposed rule also requires SEC approval. Attached is a statement issued by NASDR regarding the proposed rule. According to the NASDRs statement, "the rule imposes a number of conditions to assure that the broad spectrum of investors that may use these ratings are not misled or confused and that the ratings are not predictive, or otherwise inappropriate." Specifically, the rule would prohibit: Calling the ratings "risk" ratings; A single number or symbol being used to describe the volatility; and Subjective factors being used to make the volatility calculation. 2In addition, the proposed rule would require that: The criteria used to determine the rating be disclosed; A disclaimer be included stating that the rating is not a recommendation to buy the fund; The fact that consideration was paid in connection with the issuance of the rating be disclosed; The rating be current as of the most recent calendar quarter; and If a rating is used, all ratings issued on that same fund also be disclosed. Materials that include the volatility ratings will have to be filed and approved by NASDR prior to use. We will keep you informed of developments. Amy B.R. Lancellotta Associate Counsel Attachment (in .pdf format)

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