

MEMO# 8513

December 31, 1996

NASDR SOLICITS COMMENT ON THE USE OF BOND FUND RISK RATINGS IN SUPPLEMENTAL SALES LITERATURE

December 31, 1996 TO: BOARD OF GOVERNORS No. 67-96 SEC RULES MEMBERS No. 86-96
RE: NASDR SOLICITS COMMENT ON THE USE OF BOND FUND RISK RATINGS IN
SUPPLEMENTAL SALES LITERATURE

NASD
Regulation, Inc. ("NASDR") has issued a Notice to Members soliciting comment on the use of bond fund risk ratings in supplemental sales literature.* In particular, NASDR is seeking comment on whether it should continue to prohibit the use of bond fund risk ratings by members and their associated persons. A copy of the Notice is attached. Comments are due to the NASDR by February 24, 1997. According to the Notice, within the past two years, NASDR has received several requests from rating entities to allow the use of bond fund risk ratings in sales literature. In the past, NASDR staff has taken the position that a rating that represents a judgment of how a bond fund will react to changes in various market conditions would be predictive of fund performance or misleading and, therefore, prohibited for use by members and their associated persons in supplemental sales literature. More recently, NASDR staff has considered whether such ratings could be used if they were accompanied by disclosure designed to limit the potential that the information could be misunderstood and if the symbols used for such ratings were altered to clarify their meaning or eliminate confusion with similar symbols used for credit ratings. The Notice discusses various concerns regarding the use of bond fund risk ratings (e.g., they are predictive, potentially misleading, could be misused by salespersons and their symbols could be deceptive), as well as arguments in favor of their use (e.g., they could provide useful information to investors, use of forward-looking information is encouraged in non-mutual fund materials, NASDR could adopt rules to prevent abusive sales practices and NASDR reviews sales literature for compliance with its rules). The Notice then sets forth a number of specific questions addressing the arguments opposing and supporting the use of risk ratings that commenters are requested to consider. Amy B.R. Lancellotta Associate Counsel * NASD Notice to Members 96-84 (December 1996). Attachment