

**MEMO# 13781**

July 30, 2001

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

[13781] July 30, 2001 TO: SEC RULES COMMITTEE No. 64-01 ADVERTISING COMPLIANCE ADVISORY COMMITTEE No. 12-01 INVESTMENT ADVISERS COMMITTEE No. 19-01 RE: DRAFT INSTITUTE COMMENT LETTER ON NASDR PROPOSAL ON REQUIRED DISCLOSURES FOR SECURITIES RECOMMENDATIONS As we previously informed you,<sup>1</sup> NASD Regulation (“NASDR”) has issued a Notice to Members requesting comment on a proposed amendment to NASD Rule 2210, Communications with the Public, that would increase the disclosures required when an NASD member recommends a security in written advertisements and sales literature and that would require similar disclosures for recommendations made by an associated person during a “public appearance.” The Institute has prepared a draft comment letter to NASDR on the proposal, a copy of which is attached. The Institute’s comments are limited to the effect of the proposal on investment advisory personnel. The draft letter also requests clarification of certain aspects of the proposal. I. Application of Proposal to Investment Advisory Personnel The draft letter states that the Institute opposes the application of the proposed rule change to investment advisory personnel. First, as a general matter, the draft letter states that the Institute believes the proper context for any new requirements on investment advisory personnel is rulemaking by the SEC under the Investment Advisers Act and/or the Investment Company Act. The draft letter also notes that the proposal does not consider whether there may be any differences in the potential conflicts of interest presented by “sellside” analyst recommendations and recommendations made by portfolio managers. Most importantly, at least in the majority of cases, any potential conflicts of interest for portfolio managers would be much more attenuated. The draft letter also states that NASDR failed to take into account the fact that mutual funds already have significant procedures in place to address potential conflicts relating to the personal investment activities of investment advisory personnel. 1 Memorandum to SEC Rules Committee No. 56-01, Advertising Compliance Advisory Committee No. 10-01 and Investment Advisers Committee No. 17-01, dated July 12, 2001. 2 If NASDR determines that certain portfolio managers should be subject to the proposal, the Institute recommends that it should, in recognition of the differences in the degree of potential conflicts of interest, revise the proposed disclosure requirements as they would apply to portfolio managers to reflect these differences. In particular, NASDR should require disclosure of financial interests in a security by a discretionary account managed by a portfolio manager only when the financial interests comprise over five percent of the account’s portfolio holdings, rather than requiring disclosure of any such interest no matter

how small. The draft letter states that this change would appropriately limit the disclosure to those instances where the holdings are significant enough to materially impact the account's performance. II. Requested Clarifications The draft letter requests clarification on several matters relevant to the proposal. First, and most importantly, NASDR has not defined the term "recommendation." The draft letter states that, as a result, it is very unclear when the proposed disclosures would be triggered. For example, the Institute does not believe that a favorable comment by a portfolio manager regarding an issuer is necessarily a "recommendation" of that issuer's securities. The draft letter also states that, based on previous NASD guidance, the Institute presumes that a fund advertisement that lists the top holdings of the fund would not be considered a recommendation of those specific holdings for purposes of the proposed rule and that similarly, a statement during a public appearance by a portfolio manager that the mutual fund he manages holds a security would not constitute a recommendation. Do members agree that we should raise these issues relating to the term "recommendation"? The draft letter also seeks clarification of the proposed rule's application in the case of mutual funds or other discretionary accounts with more than one portfolio manager. Specifically, the draft letter states that the Institute presumes that in the case of a multi-managed fund, a portfolio manager would only be required to disclose information pertaining to that portion of the fund over which he has discretion. Finally, the draft letter states that it is unclear if having a "financial interest" in a security includes owning shares of an investment company that holds the recommended security. The Institute recommends that the proposed rule not require entities and individuals to look through a mutual fund (or other investment company) to determine if the fund's portfolio holds the recommended security. Comments on the proposal are due to the NASDR by August 15, 2001. If you have any comments on the draft Institute letter, please contact the undersigned by phone at 202- 371-5408, by fax at 202-326-5839, or by e-mail at [aburstein@ici.org](mailto:aburstein@ici.org) no later than August 6. Ari Burstein Associate Counsel Attachment Attachment (in .pdf format) 3