

MEMO# 13932

September 7, 2001

SEC EXTENDS THE PILOT PROGRAM FOR BOND MUTUAL FUND VOLATILITY RATINGS; DRAFT ICI COMMENT LETTER

[13932] September 7, 2001 TO: SEC RULES COMMITTEE No. 70-01 ADVERTISING COMPLIANCE ADVISORY COMMITTEE No. 16-01 UNIT INVESTMENT TRUST COMMITTEE No. 20-01 RE: SEC EXTENDS THE PILOT PROGRAM FOR BOND MUTUAL FUND VOLATILITY RATINGS; DRAFT ICI COMMENT LETTER The Securities and Exchange Commission has granted immediate effectiveness to a proposed rule change by NASD Regulation, Inc. to extend the pilot program permitting NASD members to use bond fund volatility ratings in supplemental sales literature until August 31, 2003.¹ At the same time, the SEC is soliciting comments from interested persons. The Institute has attached for your review a draft comment letter opposing the extension of the pilot program. The SEC's Release and the Institute's draft comment letter are summarized below. Comments on the extension of the pilot program must be filed with the SEC by September 18, 2001. Please provide your comments on the draft letter to the undersigned no later than the close of business on Thursday, September 13, 2001 (phone: 202/326-5819; fax: 202/326-5839; e-mail: dvanslyk@ici.org). Extension of the Pilot Program The SEC has approved NASDR's proposed rule change to amend Interpretive Material ("IM") 2210-5, which permits the use of bond fund volatility ratings in supplemental sales literature, and NASD Rule 2210(c)(3), which sets forth the filing requirements and review procedures for sales literature containing such ratings, to extend the expiration date of the pilot program to August 31, 2003. NASDR sought the SEC's approval of this two-year extension of the pilot program in order to gain additional experience with these ratings to better evaluate their "effect on the delivery of accurate and useful information to investors." NASDR has reported receipt of only six filings as of July 2001, which NASDR believes is insufficient to adequately evaluate the program's effectiveness. The notice of filing states that "low investor demand for bond funds coupled with the strong promotion of equity mutual funds during 1 See Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment No. 1 by the National Association of Securities Dealers, Inc. to Extend the Expiration Date of Rules Concerning Bond Mutual Fund Volatility Ratings, 66 Fed. Reg. 45350 (August 28, 2001) ("Release"). The original pilot program expired on August 31, 2001. See NASD Notice to Members 00-23 (April 2000). 2 much of the trial period may have contributed to the low level of filings." The Release also indicates that no changes will be made to the conditions imposed on the use of volatility ratings. Institute's Draft Comment Letter Based on the lack of participation by fund groups in the pilot program and our ongoing concerns with the use of bond fund volatility ratings, the Institute's draft comment letter opposes the extension of the pilot program. We recommend that NASDR prohibit the use of these ratings altogether. In the event that the pilot program is extended, the letter stresses the importance of rejecting any

arguments to weaken the restrictions on the use of volatility ratings to avoid putting investors at risk. The letter also strongly recommends prohibiting the use of a single symbol, number, or letter to describe a volatility rating. Finally, the letter encourages NASDR to undertake a comprehensive review of the pilot program, publish the results, and solicit further comment before determining whether to allow volatility ratings in supplemental sales literature on a permanent basis. Doretha VanSlyke Zornada Assistant Counsel Attachments Attachment (in .pdf format)

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