

MEMO# 8663

February 25, 1997

INSTITUTE SUBMISSION ON NASDR RELEASE ON RISK RATINGS

* See Memorandum to Board of Governors No. 67-96, Advertising Subcommittee No. 140-96, dated December 31, 1996 and Memorandum to Unit Investment Trust Committee No. 6-97, dated February 7, 1997. February 25, 1997 TO: BOARD OF GOVERNORS No. 10-97 ADVERTISING SUBCOMMITTEE No. 9-97 SEC RULES COMMITTEE No. 21-97 UNIT INVESTMENT TRUST COMMITTEE No. 11-97 RE: INSTITUTE SUBMISSION ON NASDR RELEASE ON RISK RATINGS

The Institute yesterday submitted the attached comments to NASD Regulation, Inc. (NASDR) in response to its request for comment on the use of bond fund risk ratings in supplemental sales literature.* A copy of the Institutes submission is attached (without the appendix referred to on page 23). In its submission, the Institute expressed strong opposition to any modification of NASDRs long-standing prohibition against the use of fund risk ratings in supplemental sales literature on the basis that: (1) such ratings are misleading insofar as they imply any certainty about a funds future investment performance; (2) the all-in depiction of risk that such ratings purport to provide is illusory, because risk is not a unitary concept nor identical for all investors; (3) the ratings are new, largely untested, prepared according to no standardized methodology and inherently subjective; (4) the ratings implicitly view risk to be synonymous with short-term volatility, a dubious standard for many investors; (5) a funds risk ratings may become quickly outdated, unbeknownst to those investors who relied on them; and (6) the services issuing the ratings are unregulated, they disclaim any liability for the accuracy of their ratings, and in the past such ratings have proved spectacularly incorrect. The Institute further stated that the problems inherent in such ratings are of such a nature that they cannot be addressed adequately through accompanying disclosure or other substantive requirements. If NASDR were to permit the use of risk ratings in sales literature, the Institute asserted that they would need to be accompanied by extensive disclosure and subject to detailed substantive standards, which would require a formal rulemaking process. Finally, the Institute stated that there are other, more appropriate means of communicating risk to investors (e.g., simplified narrative disclosure, graphic presentations). Amy B.R. Lancellotta Associate Counsel Attachment (in .pdf format)

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