

MEMO# 17967

September 10, 2004

DRAFT ICI COMMENT LETTER ON NASD PROPOSAL TO REQUIRE EXPENSE RATIOS IN FUND PERFORMANCE ADS - CONFERENCE CALL SEPTEMBER 14TH

[17967] September 10, 2004 TO: ADVERTISING COMPLIANCE ADVISORY COMMITTEE No. 4-04 SEC RULES COMMITTEE No. 76-04 SMALL FUNDS COMMITTEE No. 46-04 RE: DRAFT ICI COMMENT LETTER ON NASD PROPOSAL TO REQUIRE EXPENSE RATIOS IN FUND PERFORMANCE ADS - CONFERENCE CALL SEPTEMBER 14TH As previously indicated, the Securities and Exchange Commission recently published for comment a revised version of the NASD's proposal to require mutual fund performance advertisements to disclose the fund's standardized performance, maximum sales charge, and annual expense ratio in a prominent text box.¹ A draft of the Institute's comment letter is attached for your review and summarized below. In addition, some specific issues on which we seek members' views are highlighted below. Comments on the proposal are due no later than Friday, September 17th. The Institute will hold a conference call on Tuesday, September 14th at 2:30 pm Eastern time to discuss the draft letter. The dial-in number for the call is 888/995-9854 and the pass code is NASD/Frances Stadler. If you intend to participate on the call, please notify us by sending an email to Monica Carter-Johnson at mcarter@ici.org. If you cannot participate on the call, please provide any comments on the draft letter to Frances Stadler at 202/326-5822 (frances@ici.org) or Dorothy Donohue at 202/218-3563 (ddonohue@ici.org) before the call, if possible. The draft comment letter expresses support for initiatives to improve investor awareness of mutual fund costs and facilitate comparisons among funds. It supports requiring disclosure of a fund's annual expense ratio in performance advertisements, but emphasizes that there is no one best way for fund advertisements to communicate important information to investors. The draft letter makes the following specific recommendations.²

¹ See Institute Memorandum to Advertising Compliance Advisory Committee No. 3-04, SEC Rules Members No. 123- 04 and Small Funds Members No. 95-04 [17938], dated August 31, 2004. ² Most of these recommendations were included in the Institute's comment letter to the NASD on its original proposal. See Institute Memorandum to Advertising Compliance Advisory Committee No. 2-04, SEC Rules Members No. 9-04 and Small Funds Members No. 4-04 [17001], dated January 23, 2004. 2 Text Box Requirement. The letter recommends that NASD eliminate the text box requirement because it is unduly rigid and, in some cases, likely will result in formats that are not conducive to investor understanding of the information presented. The letter argues that the requirement is unnecessary to achieve the goal of ensuring that the required information is sufficiently prominent. It recommends that if NASD is unwilling to eliminate the requirement altogether, at a minimum it should not apply to electronic advertisements.

Question for members: The proposal provides that a fund's standardized performance, maximum sales charge, and annual expense ratio must be set forth in a prominent text box "that contains only the required information." In responding to a previous Institute comment, NASD indicated that this requirement would not preclude the use of language that states that the disclosed performance data reflects the disclosed fees and expenses. Footnote 8 of the draft letter recommends, in bracketed language, that NASD clarify how it intends to administer the "exclusivity" requirement. Do members support including this comment? Alternatively, or in addition, should we support giving funds the flexibility to include a statement to the effect that the advertised performance reflects the disclosed fees and expenses? "One Click Away" Rule. The letter urges NASD to permit broker/dealers to rely on a "one click away" rule whereby investors could click on a hyperlink in close proximity to nonstandardized performance to access the required disclosure in electronic communications. It notes that electronic media offer unique capabilities for presenting and highlighting information and states that investors will be well-served by allowing funds greater flexibility to devise appropriate ways to present the required disclosure items. Calculation of Annual Operating Expenses. The letter recommends that NASD require disclosure of the fund's annual expense ratio that appears in its most recent shareholder report (rather than the expense ratio in the fund's prospectus fee table). Question for members: The NASD's original proposal would have required the fund's annual expense ratio to be current as of the most recent calendar quarter. The revised proposal calls for disclosure of the expense ratio stated in the fund's prospectus current as of the date of submission of an advertisement for publication, or as of the date of distribution of other communications with the public. Given this change, is it still necessary/appropriate to recommend use of the annual expense ratio in the most recent shareholder report? If so, what policy arguments can be made in support of this recommendation? Compliance Date. The letter recommends that NASD provide a compliance date no less than three months from Commission approval of final requirements. Frances M. Stadler Deputy Senior Counsel Attachment (in .pdf format)