

MEMO# 11814

April 14, 2000

NASD NOTICE REGARDING NEW RULE PERMITTING BOND MUTUAL FUND VOLATILITY RATINGS

1 NASD Notice to Members 00-23 (April 2000). 2 See Memorandum to SEC Rules Members No. 18-00 and Unit Investment Trust Members No. 4-00, dated March 10, 2000 (transmitting SEC Release No. 34-42476 approving the NASD rule changes). See also Memorandum to Advertising Compliance Advisory Committee No. 11-00, SEC Rules Committee No. 49-00, and Unit Investment Trust Committee No. 11-00, dated March 24, 2000 (transmitting Institute comment letter to SEC opposing the approval of changes to the pilot program to permit the use of “a single symbol, number or letter” to describe volatility ratings). [11814] April 14, 2000 TO: ADVERTISING COMPLIANCE ADVISORY COMMITTEE No. 14-00 SEC RULES COMMITTEE No. 59-00 RE: NASD NOTICE REGARDING NEW RULE PERMITTING BOND MUTUAL FUND VOLATILITY RATINGS

The National Association of Securities Dealers recently issued a Notice to Members to inform its members of the Securities and Exchange Commission’s approval of a new NASD rule permitting the use of bond mutual fund volatility ratings in supplemental sales literature for an 18-month trial period.¹ The pilot program is effective immediately and expires on August 31, 2001, unless extended or permanently approved by the NASD on or before such date. A copy of the Notice is attached and summarized below. The Notice explains that new Rule IM-2210-5 permits the use of bond fund volatility ratings in supplemental sales literature subject to certain conditions and disclosure requirements. Additionally, the Notice states that NASD Rule 2210 regarding communications with the public was amended to require supplemental sales literature containing bond mutual fund volatility ratings to be filed for review and approval at least 10 days prior to use. The Notice also explains that new Rule 2210-5 was amended several times prior to approval by the SEC, in particular to remove the prohibition against using “a single symbol, number or letter” to describe a volatility rating.² The Notice explains that during the pilot program NASDR staff will consider, among other things, whether: (a) the rule has facilitated the dissemination of useful, understandable information to investors; (b) the rule has prevented the dissemination of inappropriate or misleading information; (c) the rule should apply to in-house ratings; (d) the rule should apply to all investment companies, not just open-end investment companies; and (e) whether additional standards or guidance are needed to prevent investor confusion or minimize excessive variability among ratings of similar portfolios. In addition, the Notice states that the staff will consider whether the use of “a single symbol, number or letter describing a volatility rating, particularly those that are similar to or the same as credit ratings, might confuse investors.” At the conclusion of its

evaluation of the pilot program, NASDR will determine whether to continue to permit the use of the ratings, permit their use with modifications to the rule, or prohibit their use. The Notice details the parameters of new Rule 2210-5, including the definition of bond mutual fund volatility rating, the limitations on the use of such ratings, the disclosures that are required to accompany any volatility rating, and the filing requirement. The Notice includes an Attachment A, which presents the text of the new rule and the text of new subparagraph (c)(3) of Rule 2210 (filing requirements and review procedures). The Notice also includes a sample disclosure statement to accompany the use of volatility ratings as Attachment B. The Institute plans to monitor the use of bond fund volatility ratings during the pilot program. To help us in this task, we ask members to provide us with copies of any sales literature containing such ratings used during the trial period. It also would be helpful for members to provide us with any sales materials that contain in-house ratings. Please send copies of these materials to the undersigned. We appreciate your assistance with our evaluation of the pilot program. Doretha VanSlyke Zornada Assistant Counsel Attachment

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