

MEMO# 3724

April 22, 1992

DRAFT LETTER TO NASD ON MATERIALITY OF EXPENSE SUBSIDIES

April 22, 1992 TO: SUBCOMMITTEE ON ADVERTISING NO. 6-92 RE: DRAFT LETTER TO NASD
ON MATERIALITY OF EXPENSE SUBSIDIES

Attached is a draft letter to the NASD that sets forth a proposed standard for determining whether an expense absorption by a fund adviser is material and, therefore, is required to be disclosed in performance advertising and sales literature. As was discussed at the last meeting of the Subcommittee, the NASD has taken the position that it is not necessary for funds that have had their expenses subsidized to recalculate total return in order to disclose what the fund's total return would have been absent the subsidy. (However, if yield is quoted, the sales literature must disclose what the yield would have been had the subsidy not been in effect.) The NASD has stated that, if a fund's expenses have been subsidized, advertisements or sales literature that contain total return data must disclose the existence of the subsidy and the fact that, had it not been in effect, the total return would have been lower if the effect of the subsidy is material (or in any event if the subsidy is still in effect). The NASD requested the Institute's views on how funds could test for materiality without actually recalculating total return, which would be burdensome and impractical. The proposed standard set forth in the attached letter, which has been reviewed by several Subcommittee members, consists of taking a simple arithmetic mean of the annual amount of the subsidy for the period in question and dividing this result by the fund's average annual total return for the same period. Quotients of greater than ten percent are considered material. The standard is intended to provide a reasonable approximation of the relation between the subsidy and total return without necessitating actual recomputation of total return. If you have any comments on the draft, please call me at 202/955-3522 by Monday, May 4. Craig S. Tyle
Deputy General Counsel Attachment