The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

COMMENT LETTER

January 18, 2001

Comment Letter on Proposed Rules for Related Performance Information, January 2001

January 18, 2001

Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: Proposed Rule Change by the National Association of Securities Dealers, Inc. Concerning Related Performance Information (SR-NASD-98-11)

Dear Mr. Katz:

The Investment Company Institute[1] appreciates the opportunity to express its views in response to the Securities and Exchange Commission's request for comment on NASD Regulation Inc.'s proposed rule changes regarding related performance information.[2] Proposed IM-2210-5 would generally permit, subject to certain conditions, three types of related performance information ("clone" performance, "predecessor" performance, and "comparison portfolio" performance) to appear in mutual fund sales material. The proposal would not permit a fourth type of related performance information ("manager performance information"), which had been under consideration by NASDR.

The Institute generally supports NASDR's proposal. We recognize that the proposal represents a significant liberalization of the types of performance information that NASD members would be allowed to present in mutual fund sales material. Nevertheless, we believe the proposal generally establishes appropriate conditions and standards governing the use of related performance information. We are particularly pleased that the proposal reflects many of our recommendations submitted in response to NASDR Notice to Members 97-47,[3] including the exclusion of manager performance information and the inclusion of language that would prevent fund sponsors from creating "incubator" private funds or accounts for the purpose of converting only those funds or accounts that have successful performance records into registered mutual funds. [4]

I. Summary of Comments

Our letter first reiterates the reasons for our strong support of NASDR's decision not to permit fund sales material to include manager performance information. We also make several recommendations that we believe would improve the effectiveness of the proposed rule and facilitate members' compliance. These recommendations are as follows:

General Standards: To avoid potential confusion, we recommend streamlining the rule by deleting the proposed prohibition on material differences between the portfolios to which the related performance relates and the advertised fund (General Standard (d)(1)).

Clone Performance: First, we recommend requiring that a clone fund's investment policies, objectives and strategies be "in all material respects equivalent" to those of the original fund, instead of requiring them to be "the same." Second, we recommend that the proposal be modified to permit funds to advertise clone fund performance where the original fund and the clone fund have different investment advisers, but the adviser to the original fund is the subadviser to the clone fund, under certain circumstances. Third, we recommend a clarification that a clone of a multiple class fund does not need to show the performance of all classes of the original fund in order to advertise clone performance.

Predecessor Performance: We recommend that funds advertising predecessor performance be required to present only one set of total return calculations, which would include the predecessor entity's performance. We also have several other specific comments regarding the presentation of predecessor performance.

Comparison Portfolio Performance: First, we recommend that a registered principal be permitted to verify that a fund's composite complies with the rules regarding the creation and maintenance of the composite, rather than requiring this verification to be performed by an independent third party. Second, we recommend that the provision prohibiting portfolio switching in comparison performance information be revised to track the AIMR standards, so as to avoid confusion and promote compliance with the rule. Third, for composites containing registered funds, we recommend that the performance be presented net of those funds' fees and that disclosure that the performance record reflects the actual fees and expenses charged to such funds be required.

Technical Comments: We recommend (1) a clarification of the point in time at which the requirement to present an advertised fund's performance in a more prominent manner than any related performance is triggered, (2) a clarification of the related performance presentation requirements for funds in operation for less than one year, and (3) a modification to the required disclosure about the impact investment company regulation might have had on an unregistered portfolio.

Our specific comments are set forth below.

II. Manager Performance Information

As noted above, the proposal would leave in place the NASD's longstanding policy of prohibiting the presentation of manager performance information (i.e., the performance of another mutual fund previously managed by the advertised fund's portfolio manager) in the advertised fund's advertisements and sales literature. The Proposing Release states that the Commission disagrees with this position and specifically solicits comment on this issue.

The Institute strongly supports NASDR's decision not to permit fund sales material to include manager performance information.

As we indicated in our 1997 Comment Letter and in a subsequent letter to the Director of the Division of Investment Management,[5] permitting manager performance information in fund sales material could mislead or confuse investors by ignoring the contributions of other investment adviser personnel and of the advisory firm itself to the fund's performance, and implying that the portfolio manager is solely responsible for the fund's performance. Moreover, the amount of time that elapses between the departure of a portfolio manager from his or her previous fund and the advertisement of the new fund's performance typically will render the manager performance information stale. For these reasons, NASDR's decision to exclude such information from the proposal is well justified.

III. General Standard (d)(1)

Under NASDR's proposal, each of the three permitted types of related performance information would be subject to specific conditions. In addition, all related performance information would be subject to a set of General Standards, which are set forth in subparagraph (d) of proposed IM-2210-5. Proposed General Standard (d)(1) generally would require that "no material difference may exist between the portfolio to which the related performance information refers and the advertised mutual fund." As discussed below, the Institute opposes this provision of the General Standards because it is unnecessary, overly restrictive and confusing.[6]

First, other provisions of the proposed rule would establish specific standards governing the required level of similarity between certain aspects of the related performance entity and the advertised fund.[7] Given these individualized standards, two of which appear to codify certain SEC staff no-action positions,[8] it is unclear why there is a need to overlay an additional general restriction governing the similarity between the related entity's and the advertised fund's portfolios in General Standard (d)(1). Indeed, while the addition of this general standard represents a significant change from the original proposal submitted to the SEC by NASDR,[9] the Proposing Release does not directly address this proposed change or offer any explanation of it.

Moreover, because proposed General Standard (d)(1) may be more restrictive than at least some of the three individual related performance information standards, it could "trump" these individual standards and inappropriately restrict funds from using related performance information. For example, a fund with a different portfolio manager than its predecessor entity would be able to advertise predecessor performance, assuming it satisfied the other conditions under proposed IM-2210-5(b). However, General Standard (d)(1) might unnecessarily preclude the fund from using predecessor performance if this change in portfolio managers were considered a material difference in the portfolios.

Finally, General Standard (d)(1) would cause confusion for funds attempting to comply with the rule. As noted above, it is unclear how General Standard (d)(1) and the individual standards are intended to interact under the proposal. Do both standards apply to a fund's policies, objectives, strategies, advisers and subadvisers? What aspects of a fund other than its policies, objectives, strategies, advisers and subadvisers is the term "the portfolio" in General Standard (d)(1) intended to encompass?[10] Confusion about the meaning and scope of General Standard (d)(1) would complicate compliance with the rule and exacerbate the restrictive nature of the provision, as fund groups may be unable to

determine whether the related performance is permitted under these overlapping similarity standards. Consequently, for all of the foregoing reasons, we recommend that General Standard (d)(1) be deleted.

IV. "Clone" Performance

A. Investment Policies, Objectives and Strategies

The Institute opposes the condition that the investment policies, objectives and strategies of an original fund and a clone must be "the same" in order to advertise clone performance.11 We understand that a clone arrangement is intended to encompass a situation where an advertised fund is basically a copy of an original fund and, consequently, that a high level of similarity between the policies, objectives and strategies is warranted to permit advertising of such clone performance. However, to require that the policies, objectives and strategies be identical would unduly restrict funds from advertising clone performance, without enhancing investor protection. For example, an original fund could have a policy related to a state's blue sky requirements that is no longer required and, thus, not included in the policies of the cloned fund. No investor would be harmed by permitting the advertisement of clone performance where the clone fund did not have this unnecessary blue sky policy. Instead of the proposed standard, we recommend using the materiality standard for similarity of a predecessor portfolio set forth in proposed IM-2210-5(b). This standard would require the policies, objectives and strategies of a clone fund to be "in all material respects equivalent" to those of the original fund. Changing the proposed standard to the predecessor materiality standard for similarity would require the policies, objectives and strategies of an original fund and its clone to be sufficiently equivalent to ensure that the presentation of clone performance would not be misleading, without unduly restricting funds from advertising clone performance.

B. Investment Adviser and Subadviser

Proposed IM-2210-5(a) would permit the use of clone performance provided, among other things, that the original fund and its clone have the same investment adviser and subadviser. We recommend that this requirement be modified to allow funds to advertise clone performance where the original fund and the clone fund have different investment advisers, but the adviser to the original fund is the subadviser to the clone fund, under certain circumstances. We believe that funds should be permitted to advertise clone performance in situations where the adviser to the clone fund delegates to the subadviser to the clone fund all of the portfolio management-related functions, and the adviser to the clone fund performs only non-investment related services, such as administrative and compliance functions for the fund. While it is critical that the entity performing the portfolio management-related services be the same, for these purposes it is not necessary that the investment adviser be the same, so long as the functions of the clone fund adviser do not in any way impact the performance of the fund.

C. Multiple Class Funds

To advertise clone performance, proposed IM-2210-5(a) would require the total return of "all" registered funds meeting certain conditions to be included. The Institute requests clarification that, where the original fund is a multiple class fund, a clone fund would not be required to show the performance of all the classes of the original fund. Instead, we believe the clone fund should be permitted to show the performance of a representative class of the original fund, which should be the class that most closely resembles the clone fund (i.e., the class with the most similar sales charges).12 Requiring the performance of the other, less similar classes of the original fund would not enhance investors' understanding of the

clone fund's performance potential, but could clutter the sales material and create confusion.

V. "Predecessor" Performance

A. Total Return Calculations

The proposal would permit the use of "predecessor" performance under certain conditions,13 including compliance with the General Standards. Proposed General Standard (d)(3)(B) would require any sales literature including related performance information to present, in a more prominent manner than the related performance information, "the total return of the Advertised Mutual Fund (excluding the performance of any predecessor portfolio)." This would require sales literature using predecessor performance to include two sets of total return calculations, one total return calculation including, and the other excluding, the performance of the predecessor entity.

In our 1997 Comment Letter, we recommended that NASDR require that, when a mutual fund has been in existence for at least one year, the fund's performance record since the conversion date be disclosed, in addition to performance information that includes the predecessor entity's performance. At that time, we believed that such a requirement would prevent over_ emphasis of the predecessor entity's performance. Since then, however, the industry has had three additional years of experience using predecessor performance in prospectuses under the guidelines set forth in the Commission's MassMutual no-action letter.14 Under MassMutual, funds can use a single set of total return numbers, which include the predecessor's performance record. In addition, despite its historical prohibition on the presentation of related performance information, the NASD has permitted predecessor performance to be presented in fund sales material in this manner.15 We are not aware of any reported abuses or instances of investor confusion as a result of funds operating under these guidelines. Consequently, and for the reasons set forth below, the Institute no longer believes that a second set of total return numbers should be required, and we recommend that proposed General Standard (d)(3)(B) be modified accordingly.16

The current method of presenting predecessor performance reflects the reality of what occurs – an unregistered private account converts into a registered fund, whereupon the unregistered entity ceases operations and its existence is thereafter terminated in due course. It is a seamless transition into a new entity. The most accurate representation of performance is therefore one performance figure incorporating the predecessor's performance record as the fund's own record, because the predecessor entity has become the new fund. Moreover, the proposed rule contains other conditions, premised on the MassMutual letter, to ensure that funds will be permitted to present predecessor performance only in appropriate circumstances.17 Given that the two entities cannot be materially dissimilar, there is no logic for requiring an additional set of performance numbers.18

B. Elimination of Portfolio After Conversion

Proposed IM-2210-5(b)(1) includes, as a condition, that the predecessor portfolio must cease "to exist" as a separate entity upon conversion to a registered fund. While a predecessor portfolio typically will cease operations upon conversion into a new fund, it does not always simultaneously cease to exist. For example, under state law, a board resolution and a corporate filing of approved articles of dissolution may be necessary to formally eliminate the remaining shell, often resulting in a delay between the conversion and the final winding up of the affairs of the predecessor portfolio. For purposes of the

proposed rule, we believe the important event is the cessation of the predecessor portfolio's operations, not the completion of its formal dissolution. We therefore recommend that the words "to exist" be replaced with the word "operations." Keying off of the cessation of operations would accommodate instances where there is a delay prior to the elimination of the predecessor portfolio shell without raising any investor protection concerns.

C. Adjustment for Fees and Expenses

Proposed IM-2210-5(b)(2) would require the performance of the predecessor portfolio to be adjusted to "reflect all current fees and expenses" of the advertised fund at the time of the conversion. We believe that this paragraph contemplates a single adjusted calculation of performance reflecting fees and expenses current at the time of the conversion, which appears to be the intent of the requirement based on the MassMutual no-action letter[19] and accepted industry practice. To clarify the provision, we recommend replacing the word "all" with the words "the then," so that the provision would read "to reflect the then current fees and expenses."

In adjusting the performance of the predecessor portfolio to reflect fees and expenses, proposed IM-2210-5(b)(2) states that the advertisement should not reflect "any fee waiver or expense reimbursement for the advertised fund." This exclusion of fee waivers and expense reimbursements did not appear in the Original NASDR Proposal, and the Proposing Release does not provide any explanation for this change. In addition, proposed IM_2210_5(c) does not require the exclusion of fee waivers and expense reimbursements from comparison portfolio performance. We are unaware of any policy reason for requiring different treatment of fee waivers and expense reimbursements in predecessor and comparison portfolio performance. Moreover, because the conversion from an unregistered predecessor entity to a registered mutual fund is in essence a seamless transition to a new entity, the most logical approach to presenting predecessor performance would be to require it to be adjusted to reflect all current fees and expenses of the advertised fund as disclosed in the fee table of the advertised fund's prospectus. We therefore recommend deleting the language "but not reflecting any fee waiver or expense reimbursement for the Advertised Mutual Fund" from the end of proposed IM_2210_5(b).

D. Permitted Predecessor Entities

Proposed IM-2210-5(b) would permit fund sales material to include predecessor performance only where the predecessor entity was an insurance company separate account, a common trust fund or a private investment company. This list should also include collective investment funds excepted under Section 3(c)(11) of the Investment Company Act. We are unaware of any policy reasons for not including collective investment funds, which are structured and operated in a manner substantially similar to common trust funds.

VI. "Comparison Portfolio" Performance

A. Independent Verification

Proposed IM 2210-5(c) would generally permit fund sales material to include the total return of a composite of other portfolios, including other investment companies, managed by the investment adviser (or, as appropriate, the subadviser) of an advertised fund, with substantially similar investment policies, objectives and strategies to the advertised fund, under certain conditions. One of the conditions of using fund comparison portfolio performance is that the investment adviser (or subadviser) of the advertised fund has

obtained verification of the composite from an independent third party.20 As we stated in our 1997 Comment Letter, we do not believe that independent verification that the creation and maintenance of the composite complies with the rule is warranted. We recommend instead that the rule require a registered principal to verify that the creation and maintenance of the composite complies with IM_2210_ 5(c)(1)(A). Having a registered principal verify the creation and maintenance of the composite would provide an effective safeguard to ensure the accuracy of the composite, without unnecessarily burdening funds. Moreover, because a registered principal is already required to approve each item of advertising and sales literature before filing it with the NASD,21 such a requirement would be a logical extension of these responsibilities. Additionally, verification by a principal would be significantly less expensive and time consuming than requiring independent outside verification.

If our recommendation to eliminate the independent verification requirement is not adopted, we suggest that the requirement be modified to require proof of independent verification on an annual basis, rather than as of the investment adviser's "most recently ended fiscal year." The importance of verification is to provide a periodic check that the creation and maintenance of the composite is in compliance with the proposed rule; it is not necessary that such verification be concluded by a certain date. However, because IM_2210_ 5(c)(1)(A)(iv) would not permit a fund to advertise composite performance until proof of independent verification has been filed with the NASD, the time required to obtain the verification could prevent a fund from advertising comparison portfolio performance during certain time periods.22 This result could be avoided by requiring the independent verification on an annual basis rather than as of a certain date. Alternatively, this problem could be addressed by implementing a grace period (e.g., three months after the end of the adviser's fiscal year) during which funds could continue to advertise composite performance based on the prior year's independent verification while waiting for the current fiscal year end certification to be prepared and filed with the NASD.

B. Portfolio Switching

The Institute also recommends that the language contained in IM-2210-5(c)(A)(iii) be simplified in order to avoid confusion. This provision permits the use of comparison portfolio performance if the composite "does not reflect any portfolio that has been switched into the composite or exclude any portfolio that has been switched into the composite or exclude any portfolio that had been switched from the composite...." We presume that this provision is intended to prohibit "cherry picking," similar to the Performance Presentation Standards established by the Association for Investment Management and Research (AIMR), which prohibit switching a portfolio in or out of a composite unless a documented change in client guidelines makes such switching appropriate. As we stated in our 1997 Comment Letter, we believe that comparison portfolio performance should be required to be computed in accordance with these AIMR standards. Accordingly, it would be preferable if the language contained in proposed subparagraph (c)(A)(iii) were deleted, and replaced with the following language, which tracks the AIMR standards addressing the issue of portfolio switching: "does not reflect any portfolio that has been switched from one composite to another unless documented changes in client guidelines make such switching appropriate."23 We believe this standard would avoid confusion and promote compliance with the rule.

C. Adjustment of Gross Performance

Proposed IM-2210-5(c)(iv) would require a composite to adjust the gross performance information of any portfolio to reflect all current fees and expenses of the advertised fund.

Consistent with our 1997 Comment Letter, we agree that this provision should apply to composites comprised of private accounts. However, also consistent with our 1997 Comment Letter, if the composite contains one or more registered investment companies, the performance of those investment companies should be presented net of actual fees and should not have to be recalculated to reflect the fees and expenses of the advertised fund. If the fees and expenses differ, we believe that this fact should be disclosed.

For many fund groups, it would be extremely difficult, if not impossible, to accurately gross up the performance of comparable mutual funds for the actual fees charged, and then net out the fees of the advertised fund for composites containing registered investment companies. In contrast to private accounts, which deduct fees monthly or quarterly, funds accrue fees daily. It is therefore a far more difficult task to account for the effects of compounding on funds. For funds, this calculation would have to be done on a daily basis going back to the inception of the composite's performance record. Additionally, the daily fee adjustment could vary if a fund in the composite has breakpoints in its fee schedule. Many fund groups do not have automated systems that will perform this calculation. Conducting this calculation manually would be prohibitively time-consuming and could introduce a risk of error.

We believe that requiring disclosure that the composite performance record reflects the actual fees and expenses of the registered investment companies included in the composite, and not the fees and expenses of the advertised fund, would ensure that presenting composite performance with mutual funds net of those funds' actual fees and expenses would not be misleading to investors. Additional disclosure that the composite performance would be different if the composite were subject to the advertised fund's fees and expenses, and that the composite performance is not predictive of the fund's performance, should also be required. We note that this disclosure approach is consistent with an earlier SEC staff position that composites including mutual funds may be presented net of actual fees, with disclosure of the differences in the fee structures of the advertised fund and the funds in the composite.[24]

We therefore recommend adding a new subparagraph (c)(1)(A)(v) to permit the performance of composites including registered investment companies to be calculated by using the actual fees of those investment companies, and to require disclosure as indicated above. This approach would sufficiently protect investors and avoid unnecessary burdens.

VII. Technical Comments

A. Date of Operation

Proposed IM 2210-5(d)(3)(B) would require that the advertised fund's performance be presented in a more prominent manner than any related performance "provided that the registration statement for the Advertised Mutual Fund has been effective for at least one year." By contrast, proposed IM 2210-5(d)(3)(C), when applicable, requires a fund to prominently disclose that the advertised mutual fund "has been in operation for less than one year." We believe that using two different time periods in these provisions serves no purpose and could cause unnecessary confusion and hinder compliance under the rule. Because there are instances where a fund does not commence operations until sometime after the fund's effective date,[25] we believe that the time period in both provisions should key off of the date the fund commenced operations. Additionally, this time period would be consistent with Item 21(b)(1) of Form N_ 1A, which requires a fund that advertises performance information to disclose in its registration statement the fund's standardized

performance information "for the periods the Fund has been in operation." Consequently, we recommend deleting the language "provided that the registration statement for the Advertised Mutual Fund has been effective for at least one year" in IM-2210-5(d)(3)(B) and replacing it with the language, "provided that the Advertised Mutual Fund has been in operation for at least one year."

B. Performance Presentations for Funds in Operation

Less Than One Year

We also request clarification regarding the interaction of proposed IM-2210-5(d)(3)(B) and (d)(3)(C). We read these two provisions to require a fund that is at least one year old[26] to present the advertised fund's performance in a more prominent manner than the related performance information, and to require a fund that has been in operation for less than one year to disclose this fact. It is our understanding that these two provisions are not intended to require a fund that has been in operation for less than one year to show the advertised fund's performance if it shows the related performance. We request confirmation that our understanding is correct.

C. Impact of Investment Company Act Regulation

Proposed General Standard (d)(3)(D)(ii)(b) would require disclosure, where applicable, that the performance of certain portfolios "may have been adversely affected had they been registered under the Investment Company Act." This disclosure may be misleading in that the effect of Investment Company Act regulation on a fund may not always be adverse. For example, the diversification requirements under Section 5(a) of the Act could prevent a fund from investing a significant portion of its assets in a stock that ultimately loses most of its value. Therefore, we recommend that the word "adversely" be deleted.

* * *

The Institute appreciates the opportunity to comment on this important proposal. If you have any questions regarding our comments, please contact me at (202) 326-5819.

Sincerely,

Doretha VanSlyke Zornada
Assistant Counsel

cc:Paul F. Roye
Director

Cynthia M. Fornelli
Deputy Director

Douglas J. Scheidt
Associate Director
Division of Investment Management
U.S. Securities and Exchange Commission

R. Clark Hooper
Executive Vice President
Disclosure and Investor Protection

Thomas M. Selman
Vice President
Investment Companies/Corporate Financing

Joseph P. Savage
Counsel
Advertising/Investment Companies
NASD Regulation, Inc.

ENDNOTES

1 The Investment Company Institute is the national association of the American investment company industry. Its membership includes 8,433 open-end investment companies ("mutual funds"), 491 closed-end investment companies and 8 sponsors of unit investment trusts. Its mutual fund members have assets of about $6.796 trillion, accounting for approximately 95% of total industry assets, and over 83.5 million individual shareholders.

2 SEC Release No. 34-43507 (Nov. 2, 2000), 65 Fed. Reg. 67025 (Nov. 8, 2000) ("Proposing Release").

3 NASDR Notice to Members 97-47 – Request for Comment on Presentation of Performance Information (August 1997); see Letter from Craig S. Tyle, Vice President and Senior Counsel, Investment Company Institute, to Ms. Joan C. Conley, Secretary, NASD Regulation, Inc., dated September 29, 1997 (commenting on NASDR Notice to Members 97_47) ("1997 Comment Letter").

4 See proposed IM-2210-5(b).

5 See Letter from Craig S. Tyle, General Counsel, Investment Company Institute, to Mr. Paul F. Roye, Director, Division of Investment Management, Securities and Exchange Commission, dated March 1, 1999.

6 Certain other provisions of the General Standards that raise issues in the context of specific types of related performance information are discussed below.

7 For example, proposed IM_2210-5(a) would permit the use of clone performance where the original fund and the advertised fund have the "same" investment policies, objectives and strategies, adviser and subadviser. Proposed IM-2210-5(b) would permit the use of predecessor performance where the investment policies, objectives and strategies of the predecessor entity are "in all material respects equivalent to" those of the advertised fund, and they have the same adviser and subadviser. Proposed IM_2210-5(c) would permit the use of comparison portfolio performance where the composite consists of portfolios with "substantially similar" investment policies, objectives and strategies to the advertised fund, and the adviser or the subadviser, as appropriate, is the same.

8 See, e.g., MassMutual Institutional Funds (pub. avail. Sept. 28, 1995) (permitting predecessor performance where each registered fund was managed in a manner that was "in all material respects equivalent" to the manner in which the corresponding predecessor unregistered account was managed); and Nicholas-Applegate Mutual Funds (pub. avail. Aug. 6, 1996 and pub. avail. Feb. 7, 1997) and GE Funds (pub. avail. Feb. 7, 1997) (permitting performance of an adviser’s other private accounts or funds that have "substantially similar" investment objectives, policies and strategies).

9 See Proposed Rule Change by NASD, Inc. Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934 (File No. SR-NASD-98-11) (Feb. 1988) ("Original NASDR Proposal").

10 For example, does the term "the portfolio" include portfolio holdings? Differences in portfolio holdings are inevitable, even in a clone arrangement. To illustrate, an investment strategy of an original fund and its clone may be to invest in telecommunications stocks. Under this strategy, the original fund may have purchased Telecom Stock A. However, at the time that the clone fund is created, Telecom Stock A's price may have risen significantly. Still following the same investment strategy, the portfolio manager may conclude that Telecom Stock B is a better investment for the clone fund.

11 Proposed IM-2210-5(a) would generally permit the total return of all registered investment companies that have the same investment policies, objectives and strategies, investment adviser and subadviser as an advertised fund to appear in fund sales material, subject to the General Standards in paragraph (d).

12 We note that under proposed IM-2210-5(d)(3)(D)(i), "any material difference between the fees and expenses of an investment company reflected in clone performance and the advertised mutual fund" would have to be disclosed.

13 Proposed IM-2210-5(b) would permit the total return of an advertised fund to include the performance of an insurance company separate account, common trust fund or private investment company that had been converted into, and had the same investment adviser and subadviser as, the advertised fund; that had investment policies, objectives and strategies that were in all material respects equivalent to those of the advertised fund; and that was not created in order to establish a performance record.

14 See MassMutual, supra note 8.

15 See Proposing Release, supra note 2, at 67027.

16 For the same reasons, the Institute also recommends that General Standard (d)(3)(D)(ii)(a), which requires disclosure that the related performance information is not the performance of the advertised fund and should not be considered indicative of or a substitute for that performance, not apply to the presentation of predecessor performance.

17 For example, as preconditions to using predecessor performance, the predecessor must: (i) cease to exist after conversion; (ii) transfer substantially all of its assets into the registered fund; (iii) have the same investment adviser and subadviser as the registered fund; and (iv) have investment policies, objectives and strategies that are in all material respects equivalent to those of the registered fund.

18 In addition, disclosure would be required by General Standard (d)(3)(D)(ii)(b) to alert investors that the prior unregistered fund was not registered under the Investment Company Act.

19 See supra note 8.

20 Proposed IM-2210-5(c)(1)(B).

21 See NASD Conduct Rule 2210(b)(1).

22 For example, if a fund's adviser's fiscal year ended in December, but the verification was

not completed and supplied to the NASD until February 1, the fund would be unable to advertise composite performance in January.

23 See AIMR Performance Presentation Standards (AIMR-PPStm), as amended and restated February 12, 1999, at Creation and Maintenance of Composites A.1.d.

24 See G.E. Funds, supra note 8.

25 For example, a fund group may have planned to launch a new fund early in the fourth quarter. However, due to various delays, the fund’s registration statement may not go effective until mid-November. For marketing reasons the fund group may not want to launch the new fund in the middle of the holiday season, so it might delay the commencement of the fund’s operations until the end of January.

26 Which, in accordance with our earlier comment, would be a fund that has been "in operation for at least one year."
