

## COMMENT LETTER

October 2, 2002

# Comment Letter Supporting Proposal to Help Investors Evaluate Investments, October 2002

October 1, 2002

Ms. Barbara Z. Sweeney  
NASD  
Office of the Corporate Secretary  
1735 K Street, NW  
Washington, DC 20006-1500

Re: Notice to Members 02-51, Investment Analysis Tools

Dear Ms. Sweeney:

The Investment Company Institute<sup>1</sup> appreciates the opportunity to comment on the recent proposal by the NASD to adopt Interpretive Material (IM) under NASD Rule 2210(d)(2)(N).<sup>2</sup> The proposed IM would allow members to provide “investment analysis tools” directly to their customers provided that (1) they comply with the disclosure requirements set forth in the IM and (2) the NASD’s staff is provided access to the tool and any sales material concerning the tool is filed with the NASD at least 30 days prior to its use. The Institute supports the proposed IM but recommends that the NASD:

- Clarify the scope of the proposed IM;
- Revise the disclosure that would be required by the IM to limit it to information that would be material to an investor utilizing an investment analysis tool;
- Delete the references to “related sales material” in subsection (c) of the IM because it is unnecessary for sales material to include the comprehensive disclosures that an investor who chooses to utilize an investment analysis tool will receive along with the tool; and
- Conform the proposed filing requirements in the IM to those in Rule 2210 and in other interpretive material adopted under that rule.

Each of these issues is discussed in more detail below.

### [I. Scope of The Proposed IM](#)

### [II. The Proposed IM’s Disclosure Requirements](#)

## A. Contents of the Disclosure Requirements Imposed on the Tool

### 1. Disclosure Item (c)(2) – The Range of All Possible Investment Outcomes

### 2. Disclosure Item (c)(4) – The Criteria and Methodology Used

### 3. Disclosure Item (c)(6) – The Universe of Investments Considered

### 4. Disclosure Item (c)(7) – Whether the Tool Favors Certain Securities

### 5. Disclosure Item (c)(8) – All Material Assumptions

## B. Disclosure Requirements for “Related Sales Material”

## III. Filing Requirements

# **I. Scope of The Proposed IM**

As proposed in the IM, the term “investment analysis tool” would be defined as “an interactive technological tool that produces simulations and statistical analyses that present a range of probabilities that various investment outcomes might occur thereby enabling investors to evaluate the potential risks of and returns on particular investments.” The Institute notes that members have long been able to provide their customers a variety of interactive investment tools without violating the prohibitions in Rule 2210(d)(2)(N). Examples include tools that allow a customer to indicate an investment goal and input personalized information such as age, financial condition, and risk tolerance, with the tool then providing the customer a list of specific securities the customer could buy or sell to meet the investment goals the customer has indicated. The NASD has also permitted the use of tools that simulate or analyze asset allocations among various asset classes or types of assets (e.g., equity vs. debt securities).<sup>3</sup> As the proposed IM would provide an exception to Rule 2210(d)(2)(N), the Institute presumes that it will have no impact on these and other tools that have been permitted under the rule. We recommend that the NASD clarify this point.<sup>4</sup>

# **II. The Proposed IM’s Disclosure Requirements**

## **A. Contents of the Disclosure Requirements Imposed on the Tool**

The Institute supports the imposition of specific disclosure obligations in connection with the use of those investment analysis tools that would be permitted under the IM. We believe that it is important for investors utilizing these tools to be provided material information concerning their capabilities and limitations. The Institute is concerned, however, that some of the discrete disclosure items proposed in the IM would result in disclosure that is either irrelevant or overly complicated, thereby causing the totality of the disclosure to be unduly confusing. To avoid this result, the Institute recommends that the IM be revised as discussed below to limit the required disclosure to information that would be material to an investor.

### **1. Disclosure Item (c)(2) – The Range of All Possible Investment Outcomes**

Proposed item (c)(2) would require a member utilizing an investment analysis tool to “prominently disclose the range of all possible investment outcomes generated by the [tool].” The Institute notes that this “range” is likely always to be the same—i.e., zero to

infinity. As such, this disclosure would probably largely be meaningless to an investor. We therefore recommend that item (c)(2) be deleted.[5](#)

## **2. Disclosure Item (c)(4) - The Criteria and Methodology Used**

This item would require disclosure of the criteria and methodology used by the tool. A footnote to this item provides details regarding specific information this disclosure should include.[6](#) The Institute recommends that this item be revised to require a more general discussion of the tool's criteria and methodology, rather than the detailed information the NASD has proposed to require (e.g., about the principles on which the tool's interest rate and inflationary analysis is based). In particular, we recommend that the IM (1) not require disclosure of each item listed in footnote 2 to this item and (2) not require that the information disclosed under this item be "detailed." Instead, the IM should provide a member the flexibility to provide a general description of only those factors that may materially impact use of the tool or its results.[7](#)

## **3. Disclosure Item (c)(6) - The Universe of Investments Considered**

Disclosure item (c)(6) would require a member to (1) disclose the universe of investments considered in the analysis and (2) state that "other investments not considered [by the tool] may have characteristics similar to those being analyzed." The Institute supports disclosure of the universe of investments considered but we oppose requiring a statement that there are other investments that may be similar to those analyzed by the tool. In light of the IM's proposed requirement that a member disclose the universe of investments considered in the analysis, investors would be put on notice that not all investments offered anywhere were considered. As such, it would not appear that this additional disclosure is necessary and we therefore recommend that this part of item (c)(6) be deleted.[8](#)

## **4. Disclosure Item (c)(7) - Whether the Tool Favors Certain Securities**

This item, which would require disclosure of whether the tool favors securities within the universe of securities considered and, if so, the reasons for this selectivity, seems directed at ensuring that an investor using the tool be aware of any bias that might affect the tool's results.[9](#) We recommend that, in connection with the disclosure required by this item, the NASD not require "negative" disclosure—i.e., disclosure that the tool does not "favor certain securities." This could be accomplished by changing the word "whether" in this item to "if."

## **5. Disclosure Item (c)(8) - All Material Assumptions**

The Institute supports the provisions of this item that would require a member to explain "all material assumptions in a clear and understandable manner." We are concerned, however, with two aspects of the disclosure that, according to footnote 4 of the proposed IM, would be required pursuant to this item. Footnote 4 states that the member's disclosure under this item "should explain fully the differences between the securities or mutual funds previously owned and the securities or mutual funds recommended so that the customer can assess the tool's analysis. If the tool recommends a mutual fund, the tool should provide information about the fund's investment objectives, fees, and expenses, and other pertinent information, and the fact that these attributes can change."

First, the Institute submits that compliance with the portion of footnote 4 that would require a member to "explain fully the differences between the securities or mutual funds

previously owned [by the customer] and the securities or mutual funds recommended,” would be virtually impossible. This is because NASD members often will not have information, or may have incomplete information, about the securities or mutual funds previously owned by the customer. We do not believe it would be reasonable to expect them to obtain this information. Accordingly, we recommend that this portion of footnote 4’s disclosure requirements be deleted.

The second aspect of this item of concern to the Institute is the requirement in footnote 4 that a tool that recommends a mutual fund provide detailed information about various specified features of the fund. The Institute recommends that, in lieu of providing this disclosure, the tool be required to provide the investor information about how to obtain a prospectus for any fund recommended to the investor and encourage the investor to read such prospectus prior to making an investment decision. We believe this approach is preferable to that proposed in the IM in that it will ensure that an investor has access to all material information on the funds recommended, not just information about certain features of the fund, thereby enabling an investor to compare fully the differences between the various funds recommended by the member and the funds currently held by the investor.

## **B. Disclosure Requirements for “Related Sales Material”**

As proposed, the disclosure requirements set forth in subsection (c) of the IM would apply to the investment analysis tool as well as to any “related sales material.” The term “related sales material” is not defined and, as a result, its intended scope is unclear. Regardless of what was intended, however, the Institute believes that sales material should not be required to include the extensive disclosures that must accompany an investment analysis tool.

For example, it would be inappropriate to impose extensive disclosure requirements on sales material that contains an incidental reference to an investment analysis tool (e.g., a brochure that merely mentions a member’s tool as one of the services offered by the member). Moreover, if sales material accompanies a tool (e.g., material delivered electronically on the same website page where an investor could utilize the tool), there is no need for the sales material to repeat the disclosures that must be provided with the tool. Finally, while we agree that the disclosures prescribed by subsection (c) of the IM are appropriate for persons who will be utilizing an investment analysis tool (subject to our specific comments earlier in this letter), those disclosures should not have to be included in sales material that is designed to promote the tool but is provided separately from the tool (e.g., a statement stuffer or brochure describing the tool).<sup>10</sup> In each case, including the disclosure prescribed by subsection (c) in sales material is unnecessary because an investor who chooses to utilize an investment analysis tool will always receive comprehensive disclosures along with the tool. We therefore recommend that the NASD delete the references to “related sales material” in subsection (c).

## **III. Filing Requirements**

As proposed, subsection (a) of the IM would require a member to provide the NASD’s Advertising Regulation Department access to the investment analysis tool “at least 30 days prior to first use.”<sup>11</sup> Consistent with Rule 2210 and other interpretive material under Rule 2210, the Institute recommends that this 30-day period be changed to a 10-day period. We note that no other provision of Rule 2210, nor any other interpretive material issued under the rule—including interpretive material previously issued under Rule

2210(d)(2)(N)—requires the filing of information with the Department more than 10 days prior to use.<sup>12</sup> As such, adherence to a 10-day period will facilitate the ability of members to utilize their current internal procedures relating to the review and filing of advertising and sales literature in connection with the use of these tools. In addition, to accommodate the timely use of these tools by members, the Institute strongly encourages the NASD to be diligent in promptly providing members feedback on any information filed with the NASD relating to these tools.<sup>13</sup>

\* \* \*

The Institute appreciates the opportunity to provide these comments on the NASD's proposed IM. If you have any questions concerning them, please contact the undersigned either by phone at (202) 326-5825, or by e-mail at [tamara@ici.org](mailto:tamara@ici.org).

Sincerely,

Tamara K. Reed  
Associate Counsel

cc: Nancy C. Libin, Assistant General Counsel  
James S. Wrona, Assistant General Counsel  
Office of General Counsel, Regulatory Policy and Oversight

Joseph P. Savage, Counsel  
Investment Companies Regulation, Regulatory Policy and Oversight

#### **ENDNOTES**

1 The Investment Company Institute is the national association of the American investment company industry. Its membership includes 8,990 open-end investment companies ("mutual funds"), 504 closed-end investment companies, and six sponsors of unit investment trusts. Its mutual fund members have assets of about \$6.615 trillion, accounting for approximately 95 percent of total industry assets, and over 88.6 million individual shareholders.

2 See NASD Notice to Members 02-51 (August 2002) (NTM 02-51). As noted in NTM 02-51, NASD Rule 2210(d)(2)(N), which prohibits a member from making predictions or projections of investment results to the public, has been interpreted by the NASD to prohibit members from providing their customers with access to automated tools "that indicate the probability that an investment strategy will produce a desired result."

3 See Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the NASD Relating to the Suitability Rule and Online Communications, SEC Release No. 34-44178 (April 12, 2001).

4 The NASD may also want to clarify that this definition is not limited to tools provided to customers via a member's website. For example, an investment analysis tool that a member provides to its clients in hard copy for the client to fill out and return to the member for the member to input into an interactive investment analysis tool would appear to fall within the proposed IM's definition of "investment analysis tool" and, consequently, should be permitted to be used subject to the IM's requirements.

5 If the NASD is not willing to eliminate this item of disclosure, it should revise the

disclosure item to permit a member to provide a representative sample or range of possible investment outcomes, as opposed to “all possible” outcomes, provided such representative sample or range is derived based upon objective criteria and such criteria are disclosed to investors.

6 This specified information would consists of “detailed information about how the tool conducts its analyses and the principles on which those analyses are based, including, but not limited to, the security- or fund-specific attributes of the recommended securities or mutual funds, transaction costs, tax implications, interest rate and inflationary analysis, historical performance, and the consistency of that performance over time.”

7 We note that the required disclosure would be subject to the NASD’s approval prior to use of the tool. See subsection (a) of the proposed IM.

8 We additionally note that a similar disclosure obligation is not imposed on a broker that recommends securities to a client.

9 Footnote 3 of the proposed IM notes that this disclosure should, “among other things,” contain specified information including “whether the investment analysis tool is limited to searching, analyzing, or in any way favoring securities in which the member makes a market or has any other direct or indirect interest.”

10 If the NASD concludes that some required disclosure is necessary in this context, we believe it should be sufficient for such sales material to include the legend prescribed by item (d)(2) of the proposed IM.

11 Any sales material concerning the tool would also be required to be filed at least 30 days prior to use. We request clarification that sales material that simply mentions the availability of an investment analysis tool would not need to be pre-filed.

12 See, e.g., IM 2210-5 relating to bond fund volatility ratings.

13 The Institute also recommends that the filing, approval, and recordkeeping requirements under Rule 2210 not apply to any amendments to a tool that are merely updates to pre-existing templates in a tool whose contents have been approved by the NASD. This approach would be consistent with the NASD’s treatment of statistical updates to members’ websites. See, e.g., Letter from Thomas M. Selman, Senior Vice President, NASD Regulation, Inc. to Forrest R. Foss, Vice President and Associate Legal Counsel, T. Rowe Price Associates, Inc., dated January 28, 2002.

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