

COMMENT LETTER

July 26, 1998

Comment Letter on Proposed Research Report Exemption, July 1998

July 6, 1998

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

Re: Proposed NASD Rule Change Concerning Filing Requirements for Independent Research Reports
(File No. SR-NASD-98-32)

Dear Mr. Katz:

The Investment Company Institute¹ appreciates the opportunity to comment on the proposal of the National Association of Securities Dealers, Inc. ("NASD") to exclude independently prepared research reports from the filing requirements of Rule 2210.² As discussed below, although the Institute generally supports the proposal, we recommend that certain changes be made to it.

Under the proposal, a research report concerning a registered investment company would be excluded from Rule 2210's filing requirements provided: (i) it is prepared by a research firm that is independent of the fund, its affiliates and the member using the report; (ii) in preparing the report, the research firm's services are not procured by the fund, its affiliates or the member using the report; (iii) the research firm prepares similar reports with respect to a substantial number of funds; (iv) the report is distributed and updated with reasonable regularity; and (v) the report has not been materially altered by the member using the report. Research reports that are not required to be filed would still be subject to the Rule 2210's content requirements and spot-check procedures.

While we generally support this proposal, we believe that certain changes should be made to it to better effectuate its purposes. First, the proposal does not include a definition of the term "research report." We understand that it is intended to cover a report that provides an in-depth analysis of a particular fund, but is not intended to cover reprints of articles that appear in widely circulated financial magazines. Accordingly, we recommend that the proposal be revised to include a definition of the term "research report" that reflects this intent. For example, the term could be defined as follows:

For purposes of Paragraph (c)(6)(G) of this Rule 2210, the term "research report" means a report that provides an in-depth analysis or discussion of a registered investment company based on (without limitation) such factors as the fund's total return, performance in comparison to an appropriate index or benchmark, and the fund's investment objectives and strategies; the term "research report" generally does not include an article that appears in a magazine, newspaper or other publication of general circulation.

Second, Paragraph (c)(6)(G)(ii) provides that, in order to qualify for the exemption, the services of the firm preparing the report have not been "procured" by the fund, any of its affiliates, or the member using the report. The use of the term "procured" raises some ambiguity as to the scope of the filing exemption. For example, research firms typically charge funds or members fees for reproducing and distributing their reports. Additionally, fund companies also often retain research firms to perform various other research services for them. We assume that the proposal is not intended to preclude a member from taking advantage of the filing exemption under these circumstances. One possible revision to remove this ambiguity would be to substitute the word "initiated" for "procured" in that clause. This would make clear that the research report would be eligible for the filing exemption so long as the fund, its affiliates or the member using the report did not request that the report be prepared. Alternatively, language could be included in the release adopting the proposal making clear that the circumstances described above do not preclude use of the filing exemption.

Third, Paragraph (c)(6)(G)(iv) provides that a research report must be distributed and updated with reasonable regularity.³ In some cases, a report may contain performance information that is not current as of the most recent calendar quarter-end. The proposal should be amended to provide that if a research report contains outdated performance information, it must be accompanied by performance information that meets the requirements of SEC Rule 482(f) under the Securities Act of 1933.

Fourth, although we assume that the proposal is intended to exempt research reports that include performance ranking information (provided they meet the criteria under Paragraph (c)(6)(G)), this is not clear. Therefore, either the rule should be revised expressly to allow research reports to include performance ranking information, or the release adopting the proposal should clarify that research reports may include performance ranking information.

Finally, Paragraph (c)(6)(G)(v) provides that, in order to be eligible for the filing exemption, the research report may not be materially altered. Often members will alter research reports in order to comply with applicable SEC and NASD standards. For example, if the report contains ranking information, the member may in some circumstances be required to add disclosure to make the report consistent with the NASD's Ranking Guidelines. Similarly, a member may be required to delete information regarding an unaffiliated fund that is mentioned in the research report but that is not offered by the member. We assume that alterations that are intended to make a research report consistent with applicable standards would not be regarded as "material." The final rule (or the release accompanying the final rule) should make this clear. If this assumption is not correct, Paragraph (c)(6)(G)(v) should be revised to add at the end of that clause: "except to the extent necessary to make the report consistent with applicable regulatory standards."

We appreciate the opportunity to comment on this proposal. If you have any questions, please contact the undersigned at (202) 326-5819.

Sincerely,

Joseph P. Savage
Assistant Counsel

cc: Katherine A. England
Assistant Director
Division of Market Regulation
Securities and Exchange Commission

John M. Ramsay
Vice President and Deputy General Counsel
NASD Regulation, Inc.

Thomas M. Selman
Vice President
Investment Companies and Corporate Finance
NASD Regulation, Inc.

ENDNOTES

1 The Investment Company Institute is the national association of the American investment company industry. Its membership includes 7,091 open-end investment companies ("mutual funds"), 437 closed-end investment companies, and 9 sponsors of unit investment trusts. Its mutual fund members have assets of about \$4.989 trillion, accounting for approximately 95% of total industry assets, and have over 62 million individual shareholders.

2 Securities and Exchange Commission Release No. 34-40074 (June 4, 1998); 63 Fed. Reg. 32690 (June 15, 1998).

3 We assume that this requirement means that the research firm must update the report with reasonable regularity, and not that the member distributing the report is required subsequently to continue to provide updated versions of a research report to customers receiving the report.

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