



# INVESTMENT COMPANY INSTITUTE

April 24, 2003

Mr. Jonathan G. Katz  
Secretary  
U.S. Securities and Exchange Commission  
450 Fifth Street, NW  
Washington, DC 20549-0609

Re: NASD Proposed Interpretive Material  
Regarding the Use of Investment Analysis  
Tools; File No. SR-NASD-2003-13

Dear Mr. Katz:

The Investment Company Institute<sup>1</sup> appreciates the opportunity to comment on the proposal by the National Association of Securities Dealers (NASD) to adopt Interpretive Material (IM) under NASD Rule 2210(d)(2)(N). The proposed IM would allow members to provide "investment analysis tools" to their customers provided that (1) the tool complies with the requirements set forth in the IM, (2) the member using the tool or any related written reports or sales material provides specified disclosures regarding the tool, and (3) at least 30 days prior to first use, the member provides the NASD's Advertising Regulation Department access to the tool and files with the NASD any template for written reports produced by, or sales material concerning, the tool.

## I. COMMENT PERIOD

Before commenting on the proposed IM, the Institute is compelled to express its concern with the insufficient amount of time the Commission has provided interested persons to comment on the proposal – *i.e.*, the bare minimum 21-day period. As the Institute has noted several times in the past,<sup>2</sup> such a short comment period makes a mockery of the public comment

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<sup>1</sup> The Investment Company Institute is the national association of the American investment company industry. Its membership includes 8,912 open-end investment companies ("mutual funds"), 554 closed-end investment companies and 6 sponsors of unit investment trusts. Its mutual fund members have assets of about \$6.254 trillion, accounting for approximately 95% of total industry assets, and 90.2 million individual shareholders.

<sup>2</sup> *See, e.g.*, Letter from Craig S. Tyle, General Counsel, Investment Company Institute, to Mr. Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission, dated April 15, 2003 (File No. SR-NASD-2002-141)(Proposed Amendments to NASD Rules Regarding Board Independence and Independent Committees); Letter from Craig S. Tyle, General Counsel, Investment Company Institute, to Mr. Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission, dated April 6, 2001 (File No. S7-03-01)(Proposed Rule Changes of Self-Regulatory

process inasmuch as 21 days does not constitute a meaningful opportunity to comment. This is particularly true in the case of a trade association that needs time to obtain appropriate input from its members, achieve consensus, and then complete its comment letter. Moreover, it is wholly unnecessary to have such a brief comment period on this particular proposal – there is no emergency demanding that the Commission act so expeditiously in this matter. As such, we are at a loss to understand the truncated comment period. The comments set forth below represent our good faith effort to provide useful feedback to the Commission on behalf of our members within the short time allotted. We strongly urge the Commission to lengthen the public comment period for any future significant self-regulatory organization rule proposals.

## II. SUMMARY OF COMMENTS

The Institute generally supports the proposed IM. We believe it will benefit investors by providing them access to valuable resources to analyze the panoply of available investment options, thereby enabling them to make more informed investment decisions. We are interested in ensuring that the conditions imposed by the IM to protect investors are not so burdensome so as to inadvertently discourage members from offering investment analysis tools. We are pleased, therefore, that many of the recommendations we made to the NASD on its original proposal are reflected in the current proposal.<sup>3</sup> We recommend, however, that the NASD make the following additional revisions to the proposed IM:

- Eliminate the requirement in the IM that the mathematical process used by the tool be one that can be “audited.”
- Eliminate the requirement to disclose that other investments not considered by the tool may have characteristics similar or superior to those being analyzed by the tool.
- In lieu of requiring that the tool *and* each piece of related sales material *and* each written report generated by the tool include the same disclosure, provide members the flexibility to determine how such disclosure is provided to investors, so long as the totality of the disclosure satisfies the requirements of the IM.
- Conform the proposed filing requirements in the IM to the NASD’s existing filing requirements under Rule 2210.

Each of these recommendations is discussed in more detail below.

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Organizations); and Letter from Craig S. Tyle, General Counsel, Investment Company Institute, to Mr. Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission, dated January 9, 2001 (File No. SR-NASD-00-59)(Nasdaq Mutual Fund Quotation Service).

<sup>3</sup> See Letter from Tamara K. Reed, Associate Counsel, the Investment Company Institute, to Barbara Z. Sweeney, NASD, Office of the Corporate Secretary, dated October 1, 2002.

### III. COMMENTS ON THE PROVISIONS OF THE IM

#### A. Conditions Imposed on the Tool

As revised, the proposed IM would require an investment analysis tool to use “a mathematical process that can be audited and reviewed.”<sup>4</sup> Neither the IM nor the Commission’s release discusses what is intended by the requirement that the tool use a mathematical process that can be “audited.” Inasmuch as we assume that this condition is designed to assure a level of transparency in how a given tool works, the “audit” requirement seems redundant of the requirement that the tool use a mathematical process that can be “reviewed.” We therefore recommend that the words “audited and” be deleted. At the very least, the NASD should clarify that this condition does not contemplate the need for members to engage a third party to conduct an audit of the tool’s mathematical process.

#### B. Disclosure Requirements

##### 1. Disclosure of Characteristics of Securities Not Considered

The Institute is pleased that many of the disclosure requirements originally proposed by the NASD have been revised as recommended by the Institute in order to clarify the provisions of the IM or to eliminate disclosure that did not appear necessary to protect investors. Along these lines, we recommend an additional change to the disclosure requirements to eliminate unnecessary disclosure. As proposed, subsection (c)(6) would require a member to describe the universe of investments considered in the analysis, include information about the tool’s selection process, and state that “other investments not considered [by the tool] may have characteristics similar or superior to those being analyzed.” While we support disclosure of the universe of investments considered and information concerning the tool’s selection process, we continue to oppose requiring a statement that there are other investments not considered that may have characteristics similar or superior to those analyzed by the tool. As we stated in our previous comment letter, 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.<sup>5</sup>

##### 2. Scope of Disclosure Requirements

As originally proposed, the disclosure requirements set forth in the IM would apply to the investment analysis tool as well as to any “related sales material.”<sup>6</sup> In the current version of the proposed IM, these disclosure requirements would also apply to any “written reports

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<sup>4</sup> See proposed IM subsection (c)(3).

<sup>5</sup> We additionally note that a similar disclosure obligation is not imposed on a broker that recommends a security to a client.

<sup>6</sup> The Institute is pleased that the IM has been revised to clarify that sales material that contains only an incidental reference to an investment analysis tool does not need to include the disclosures required by the IM or be filed with the NASD, unless otherwise required by Rule 2210.

indicating the results generated by [the tool]." The Institute believes that applying the same disclosure requirements to each of these items will lead to unnecessary duplication that is not helpful to investors. While it is important for an investor utilizing an investment analysis tool to understand how it operates and its limitations, it is not necessary for investors to be provided this same disclosure over and over again.

We believe a better approach would be for the NASD to provide members who offer an investment analysis tool the flexibility to determine how such disclosure should be furnished to investors. For example, rather than requiring the member to describe the criteria and methodology used in the tool, in each piece of related sales material, and in each written report generated by the tool, the member could determine where disclosure of this information would be most appropriate, so long as the totality of the disclosure provided to the investor includes all elements of disclosure required by the IM. We believe that this approach, which fulfills the NASD's interest in ensuring that specified information is provided to all investors utilizing a tool, would result in more effective disclosure. We are concerned that repetition of the same disclosure in a variety of documents would begin to look more like boilerplate and be treated by investors accordingly.

It bears emphasizing that, notwithstanding this additional flexibility we recommend be provided to members, the NASD's staff will be in a position to determine whether the member has effectively communicated each of the items of disclosure in the totality of the information provided to investors. This is because subsection (a) of the proposed IM would expressly require that, *prior to first use*, the NASD be provided access to a member's tool, any related sales material, and the template for any written reports produced by the tool. As such, the staff will be able to determine the appropriateness of the placement of the disclosure and the adequacy of its substance. Importantly, in the event the staff has concerns regarding the placement or adequacy, the IM would prohibit a member from using the tool, the related sales material, or the written report template until "all changes specified by the [staff] have been made by the member and approved by the [staff]."

### C. Filing Requirements

As noted above, subsection (a) of the proposed IM would require a member to provide to the NASD, "at least 30 days prior to first use," access to the investment analysis tool and to file with the staff any template for written reports produced by, or sales material concerning, the tool. Consistent with NASD Rule 2210 and other interpretive material under the rule, 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 NASD more than 10 days prior to use.<sup>8</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, the Institute recommends that the filing, approval, and recordkeeping

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<sup>7</sup> See proposed IM subsection (a).

<sup>8</sup> See, e.g., IM 2210-5 relating to bond fund volatility ratings.

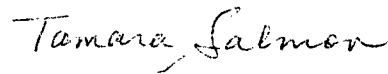
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requirements under Rule 2210 not apply to any amendments to the tool, its related sales material, or the written reports indicating the tool's results that are either non-substantive or merely updates to pre-existing templates that were previously approved by the NASD. This approach would be consistent with the NASD's treatment of statistical updates to members' websites.<sup>9</sup>

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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. Salmon  
Senior Associate Counsel

cc: Paul F. Roye, Director  
Division of Investment Management  
U.S. Securities and Exchange Commission

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

NASD

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<sup>9</sup> 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.