

## Comment Letter on NASDR Proposals Re Communications with the Public, November 1999

October 29, 1999

Ms. Joan Conley  
Office of the Corporate Secretary  
NASD Regulation, Inc.  
1735 K Street, N.W.  
Washington, D.C. 20006-1500

### Re: NASD Regulation Request for Comment 99-79

Dear Ms. Conley:

The Investment Company Institute<sup>1</sup> appreciates the opportunity to express its views in response to NASD Regulation's (NASDR) request for comment on proposed amendments to its rules governing communications with the public.<sup>2</sup> The proposed amendments, among other things, would: (i) exempt from Rule 2210's pre-use approval requirement, filing requirements and some of its content requirements member firm communications to institutional investors;<sup>3</sup> (ii) exempt from the pre-use approval and filing requirements form letters and group e-mail to existing retail customers and fewer than 25 prospective retail customers; (iii) exempt from the filing requirements article reprints and certain press releases regarding investment companies; and (iv) simplify the standards applicable to member communications.<sup>4</sup>

The Institute generally supports NASDR's proposed amendments. We commend NASDR for undertaking this initiative to reexamine and modernize its rules governing communications with the public to enhance the effectiveness with which these rules protect investors. We are particularly pleased that the proposed amendments reflect many of our suggestions submitted in response to NASDR's Request for Comment 98-81,<sup>5</sup> including the proposed distinction between institutional and retail investors. We also applaud NASDR's proposed exemptions from the filing requirements for institutional sales material, certain form letters and group e\_mail,<sup>6</sup> article reprints, and certain press releases, which would ease the volume of filings that NASDR staff must review, without compromising investor protection. We anticipate that this filing relief will help NASDR staff to better manage the content reviews of filings that continue to be required under the advertising rules.

We do have several recommendations that we believe would further improve the effectiveness of the advertising rules and facilitate members' compliance. First, to ensure consistency in the application of the advertising rules, we recommend that NASDR distinguish between institutional and retail materials when it issues interpretive guidance. We also recommend that the definition of "institutional investor" be expanded to include Certified Financial Planners and persons who hold other specified professional designations, as well as any qualified retirement plan that covers 100 or more participants. Additionally, we recommend that the definition of "institutional investor" include any entity or individual meeting a designated asset threshold (e.g., \$5 million or \$10 million) that is substantially lower than the proposed \$50 million level set forth in Rule 3110(c)(4). These changes would increase the benefits of the institutional/retail distinction by permitting members to treat a larger universe of financially sophisticated entities and individuals as institutional investors under the advertising rules, without raising investor protection concerns.

Second, because reprints of articles prepared by independent third parties do not raise the same concerns as materials prepared by a member or its affiliates, we request that such reprints only be subject to the content standards requiring sales material to be fair and balanced and not false or misleading. Third, we oppose NASDR's proposal to mandate that "material information" appear in the main text of an advertisement, rather than in footnotes. We believe that the current rule's more flexible approach, which requires members not to use footnotes in a way that will make a given advertisement misleading, is more appropriate in that it permits members to create advertisements that are readable, without being misleading. Additionally, we recommend that NASDR delete proposed Rule 2210(a)(1)(E) in its entirety because it is inappropriate to mechanically apply to unscripted oral communications the same standards that apply to written materials or prepared oral remarks, the content and length of which generally are within a member's control.

Finally, we also: (i) have other specific comments on proposed changes to the content standards; (ii) suggest modifications to the filing requirements for some materials; (iii) recommend that NASDR permit fund family rankings; and (iv) provide several other, more technical comments.

Each of these recommendations is discussed in greater detail below.

## I. Communications with Institutional Investors

### A. Distinction between Institutional and Retail Investors

We commend NASDR for recognizing the need to differentiate between institutional and retail investors under NASDR advertising rules. This distinction is appropriate because institutional investors are generally more sophisticated than typical retail investors for various reasons, including their education, training and/or experience in the financial markets and mutual fund products, their access to additional resources to obtain independent information, and their access to high-level personnel at mutual fund complexes. Consequently, materials sent to institutional investors should not be subject to the same requirements designed to protect less sophisticated retail investors. We therefore support the proposed exemption for "institutional sales material"<sup>7</sup> from the pre-use approval and filing requirements,<sup>8</sup> and from some of the content requirements.

To ensure consistent application of the advertising rules, and in view of the appropriateness of the institutional/retail distinction, we urge NASDR to apply the proposed distinction between institutional and retail sales materials when it issues interpretive guidance. That is, when issuing interpretive guidance designed to address retail investor protection concerns,<sup>9</sup> NASDR should clearly limit the applicability of the guidance to "advertisements" and "sales literature," thereby excluding "institutional sales material." The institutional/retail distinction, of course, also should be reflected in future NASDR rulemaking initiatives.

### B. Definition of Institutional Investor

As noted above, NASDR's new definition of "institutional sales material" would cover sales material that is distributed only to institutional investors. NASDR proposes to define "institutional investor" for this purpose to include persons or entities described in Conduct Rule 3110(c)(4)<sup>10</sup> as well as any NASD member or an associate person of a member.<sup>11</sup> While we agree that it is appropriate to treat the foregoing persons and entities as "institutional investors," we recommend that NASDR expand the definition to include certain additional persons and entities that do not need the same level of protection under NASDR's advertising rules as retail investors.<sup>12</sup>

First, we recommend that the definition include Certified Financial Planners (CFPs). CFPs undergo training and a rigorous examination administered by the Certified Financial Planner Board of Standards in order to receive their CFP certification. Consequently, CFPs attain a level of expertise in financial matters that distinguishes them from typical retail investors.<sup>13</sup> Second, the definition should include any qualified retirement plan that covers 100 or more participants.<sup>14</sup> The proposed 100-participant threshold would provide a reasonable proxy for sophistication in the retirement plan context.<sup>15</sup>

Finally, the definition of institutional investor should include any entity or individual meeting a designated asset threshold substantially lower than the proposed \$50 million level set forth in Rule 3110(c)(4). Lowering the proposed asset requirement to a threshold amount (e.g., \$5 million or \$10 million) for which there is precedent for treating sophisticated investors differently, would be appropriate.<sup>16</sup> This change would increase the benefits of the institutional/retail distinction by permitting members to treat a larger universe of financially sophisticated entities and individuals as institutional investors under the advertising rules, without raising investor protection concerns.

## II. Treatment of Article Reprints

We support NASDR's proposed exemption from the filing requirements for any article reprint that has not been "materially altered" by the member.<sup>17</sup> We believe that the same reasoning that led NASDR to propose exempting article reprints sent to retail investors from the filing requirements<sup>18</sup> also justifies modifying the application of the content standards of Rule 2210 to third-party article reprints sent to either retail or institutional investors. In particular, the Notice cites arguments that reprints often are available to the public through large circulation periodicals, and that members have little control over the content of these articles. On this basis, we believe it is also appropriate to subject third-party article reprints that have not been materially altered by the member to only the standards set forth in proposed Rule 2210(d)(1) and (d)(2).<sup>19</sup> Application of these standards would ensure that "members could not distribute an article reprint that contains false or misleading statements."<sup>20</sup>

Many of the other, more specific, content standards are unduly burdensome in the context of reprints published by unaffiliated third parties. Members often distribute reprints of articles published in third-party publications that provide investors with independent analysis helpful in making investment decisions. These reprints may contain ranking information, fund comparisons and/or

descriptions of mutual fund or brokerage companies and their services, but may not comply with all of the detailed requirements of the content standards. To conform such reprints to certain of the content standards often requires a member to add substantial disclosure to the reprint, which may fill more than one page. For example, if a reprint contains the names of several funds and a ranking or comparative fund analysis, the member may be required to add substantial disclosure regarding the fund ranking or comparison to the reprint. This often delays the speed with which members may provide this valuable and often requested information to investors, and fills the reprint with cumbersome disclosure which obscures its intended message.

In addition to being subject to the content standards set forth in proposed Rule 2210(d)(1) and (d)(2), we agree that third-party article reprints sent to retail investors should remain subject to the pre-use approval requirement. This requirement would provide an additional layer of protection against the dissemination of false or misleading reprints. These safeguards, combined with the protection that such reprints would have to be from publications produced by unaffiliated third parties over which the member has no control, would ensure that article reprints are fair and balanced without being filled with cumbersome and unnecessary disclosure.

### III. Standards Applicable to Member Communications

#### A. Content of Footnotes

The Institute opposes NASDR's proposed change to its treatment of the content of footnotes. NASDR currently requires members, in judging whether a communication may be misleading, to consider that material disclosure included in legends or footnotes may not enhance the reader's understanding of the communication.<sup>21</sup> Proposed Rule 2210(d)(3), however, would require that: "material information must appear in the main text of the communication and may not be relegated to the footnotes." NASDR has thus changed this provision from guidance about a factor that members may consider in the context of a particular communication, to a specific mandate without regard to the context. Moreover, because what constitutes "material information" for these purposes would not be clear, this change likely would lead to advertisements that are cluttered and difficult for investors to read, potentially obfuscating the most important information.<sup>22</sup> For these reasons, we believe that the current rule's more flexible approach, which requires members not to use footnotes in a way that will make a given advertisement misleading, is far more appropriate.

If NASDR is disinclined to follow our recommendation, however, we strongly urge NASDR to include a statement in the adopting release to the effect that it recognizes the important role footnotes play in making materials more readable for investors, and that it does not intend proposed Rule 2210(d)(3) to prohibit the appropriate use of footnotes in advertisements.

#### B. Predictions and Projections

The Institute opposes NASDR's proposed deletion of the language "hypothetical illustrations of mathematical principles are not considered projections of performance..." in proposed Rule 2210(d)(4) (governing predictions or projections of performance). Such illustrations are not, in fact, predictions or projections of performance. However, deleting this language could cause confusion on this point. Moreover, the Notice does not discuss this change, nor are we aware that the NASD has changed its position on this issue. We therefore recommend that the deleted language be reinserted in proposed Rule 2210(d)(4).

#### C. Testimonials

As under the current rules, NASDR's proposed standards applicable to communications with the public would include provisions concerning testimonials. In contrast to the current rule, which addresses "testimonials concerning the quality of a firm's investment advice," the proposed amended rule would govern "any testimonial concerning a member's products and services. Because the Notice does not discuss this language change, it is unclear if NASDR considered whether all of the disclosures that are required to accompany a member's use of testimonials in sales materials would be appropriate in the context of a testimonial concerning a member's services. For example, requiring disclosure that a testimonial concerning a member's telephone or Internet website service is no guarantee of future performance or success would be a non sequitur.<sup>23</sup> We therefore request clarification concerning the applicability of the disclosure requirements under proposed Rule 2210(d)(5) to testimonials limited to members' services that are not related to investment performance.

#### D. Comparisons

Institute members have reported that compliance with NASDR staff interpretations of the provision governing members' use of comparisons in advertisements<sup>24</sup> typically has required adding extensive disclosure to the advertisement that obscures the member's intended message to investors. These interpretations seem inconsistent with NASDR's proposed guideline IM-2210-1(3), which requires members' communications to be clear, and cautions that "a complex or overly technical explanation may be more confusing than too little information." To enable members to effectively use comparisons under the advertising rules, we encourage NASDR to review its standards in this area and consider alternative approaches that would permit the use of comparisons that provide clear, meaningful information and do not raise investor protection concerns.

We also recommend a modification to the language in proposed Rule 2210(d)(7) that states that members must disclose all material differences between comparisons, "including investment objectives, costs, ...." This language could be interpreted to mean that the listed items are necessarily material in all cases, which may not be true, and seems contrary to NASDR's intended goal of providing greater clarity and conciseness to its advertising rules. Therefore, we propose instead that the language read "including (as applicable) investment objectives, costs, ...."

## E. Press Releases

The Institute supports the proposed exemption from the filing requirements for press releases concerning investment companies that are provided only to members of the media.<sup>25</sup> For purposes of the content requirements, we recommend that such press releases be subject to the same liberalized treatment as "institutional sales material" because they are not distributed as offers for investment, and the press modifies and reproduces them as it deems appropriate for a particular use.

## IV. Public Appearances

Proposed Rule 2210(a)(1)(E) defines various types of public appearances and speaking activities as communications with the public subject to certain content standards under Rule 2210.<sup>26</sup> The Institute recommends that NASDR delete proposed Rule 2210(a)(1)(E) in its entirety because it is inappropriate to mechanically apply to unscripted oral communications the same standards that apply to written materials or prepared oral remarks, the content and length of which generally are within a member's control. It is inherently difficult to monitor all remarks and apply disclosure standards in venues, such as interviews or seminars, where much of the communication is conversational. For example, a person who is being interviewed or participating in a seminar often does not control the length of the interview or seminar or the amount of time he or she has to answer a given question. Thus, it can be difficult to ensure that remarks made in these situations are "balanced" as that standard has been applied by the NASDR staff in the context of written materials. Similarly, time limitations may make it impossible to answer a question about performance in a public appearance while ensuring that it complies with all of the requirements in proposed Rule 2210(d)(4).<sup>27</sup> Moreover, application of these disclosure standards could make it all but impossible to provide a responsive answer to a specific question (e.g., a question soliciting an opinion about future market trends).

If NASDR is not inclined to implement our suggestion, we recommend that it narrow proposed Rule 2210(a)(1)(E) to cover only those public appearances that are organized (i) by or under the control of a member and (ii) for the purpose of promoting the sale of fund shares. This change would provide needed flexibility for public appearances or other speaking activities where the member does not control the format and timing of the appearance or activity and/or the appearance or activity has a predominantly educational purpose.<sup>28</sup>

## V. Filing Requirements

### A. Shareholder Reports

NASDR has encouraged comment on whether mutual fund shareholder reports should be exempt from the filing requirements under NASDR advertising rules. We believe that they should be exempt for the following reasons. First, the Notice expresses NASDR's concern that "members frequently supplement the management's discussion of fund performance (MDFP) with marketing material that goes far beyond the SEC regulatory requirements for shareholder reports."<sup>29</sup> However, we understand that in most instances shareholder reports are subject to only limited review, which suggests that the addition of extensive marketing material in shareholder reports may not be occurring to the extent that the Notice implies. Second, shareholder reports continue to be subject to the scrutiny of the SEC during regular and special audits and to specific content requirements under the securities laws. They would also continue to be subject to NASD spot checks and review during NASD examinations. Accordingly, we urge NASDR to reconsider its position and exempt mutual fund shareholder reports from the filing requirements.

If NASDR is not inclined to follow our recommendation, we urge NASDR to require members to file shareholder reports only if they contain marketing material that goes beyond SEC regulatory requirements and, consistent with NASDR's current practice, to require members to file only those sections (e.g., the president's letter) of the report that contain such marketing material.

### B. Backup Filing Requirement

The proposed amendments would continue to require members to file a copy of the ranking or comparison used in sales materials that contain rankings.<sup>30</sup> However, NASDR invites further comment on eliminating this backup filing requirement. This requirement does not appear necessary in those instances where the items are readily available to NASDR staff, or where different pieces of sales material rely on the same backup. Accordingly, to decrease the administrative burden on members while preserving NASDR's ability to review backup material for sales materials that contain rankings, we recommend that NASDR eliminate this filing requirement and instead require the filing of backup materials only upon request in those instances where the backup material is not

readily available to NASDR staff. In implementing our recommendation, NASDR should not require filings of the same backup material previously filed with NASDR.

## C. Generic Fund Advertisements

NASDR invites comment on whether generic fund advertisements should be exempt from the filing requirements under the advertising rules. As we have stated previously, "generic" advertisements complying with Rule 135a under the Securities Act of 1933 should be exempt from the filing requirements because such advertisements do not involve significant investor protection issues.<sup>31</sup> Generic advertisements are most often used to educate investors about investing concepts, such as dollar cost averaging, and are not permitted to be used to promote sales of a particular fund. Moreover, the contents of generic advertisements are strictly limited under Rule 135a, and would continue to be subject to spot checks and review by both the NASD and the SEC during examinations.

As justification for retaining the filing requirement, the Notice states NASDR's concern that members might not fully understand the content requirements of Rule 135a, and as a result, might fail to file sales material that should be filed. We do not believe that this concern should preclude NASDR from exempting generic advertisements from the filing requirements. Rather, NASDR could provide further guidance on Rule 135a material to help correct any possible misunderstandings of the content requirements of that rule and proceed with exempting generic material from the filing requirement.

## D. Electronic Filing of Sales Material

NASDR states that it is examining the means to permit electronic filing of sales material and will work with members to determine if this is feasible. We reiterate our position that electronic filing would be much more efficient than the current paper filing requirement and encourage NASDR to move quickly to permit electronic filing for sales material that is delivered electronically, as well as for all other sales material, including print materials.<sup>32</sup> Additionally, NASDR should implement procedures to enable staff to provide advertising review comment letters to members electronically.<sup>33</sup>

## VI. Fund Family Rankings

NASDR requests comment on whether the Ranking Guidelines<sup>34</sup> should permit sales materials to include rankings of entire fund families. We believe they should. Fund family rankings can be an important consideration by investors who wish to allocate their assets among more than one fund. We believe that this important information should be made available to investors and that NASDR's concerns regarding confusing or misleading investors could be appropriately addressed through disclosure. For example, NASDR could require any fund using family rankings to disclose that the ranking of any single fund in the family may be different from the ranking shown for the fund family, and that information about a particular fund may be obtained from its prospectus.

## VII. Other Technical Comments

### A. Approval and Recordkeeping

#### 1. Proposed Rule 2210(b)(3)

Proposed Rule 2210(b)(3) requires that "the file must include the name of each person who prepared and approved each advertisement" instead of the current "prepared and/or approved" in Rule 2210(b)(2). We request clarification whether NASDR intended a substantive change by the deletion of "/or," which would require members to maintain the names of two different people if the same person did not approve and prepare the advertisement. More importantly, maintaining the name of the preparer of an advertisement is not necessary as long as the name of the registered principal who approves each advertisement and is ultimately responsible for its content, regardless of who prepared it, is recorded in the file. We therefore believe that NASDR's regulatory purposes will be fully served by simply requiring the name of each person who approved the advertisement.

#### 2. Proposed Rule 2210(b)(4)

Proposed Rule 2210(b)(4) requires members to maintain information "concerning the source and data of any statistical table..., " whereas current Rule 2210(d)(2)(K) requires members to "disclose the source" of information from charts, tables, etc. We request that NASDR continue to require members to disclose the source of information from charts, tables, etc., and delete the proposed additional requirement of maintaining data. It is unclear what such data would comprise, and the Notice does not cite any deficiency in the information that members currently are required to maintain.

### B. Definition of "Existing Retail Customer"

The proposed amendments would define "existing retail customer" as "any person who has opened an account with a member and is not an institutional investor."<sup>35</sup> We are concerned that this definition may unintentionally exclude retail customers who open accounts directly with a mutual fund transfer agent rather than with an introducing member firm. Because we believe that "existing retail

customers" should include customers who open accounts directly through a transfer agent as well as those who open accounts through an introducing member firm, we suggest that the definition be revised to read "any person who has opened an account with a member, or with any registered investment company for which that member serves as principal underwriter."

## C. Ranking Guidelines

We oppose NASDR's proposed change to the time periods required for certain investment company rankings included in advertisements or sales literature.<sup>36</sup> To maximize the standardization of ranking disclosure, we believe it is important to continue requiring members to provide one, five and ten year ranking information if published by the Ranking Entity as defined in IM\_2210\_3.<sup>37</sup> Deleting this requirement could adversely impact the comparability of rankings among funds and open the door to possible abuses such as "cherry picking" time periods that reflect most favorably on a fund's performance, which would confuse, and potentially mislead, investors.<sup>38</sup> Therefore, to provide investors with the best opportunity to make valid performance comparisons among funds, we recommend that NASDR maintain the requirement that rankings based on total return be accompanied by one, five and ten year rankings based on total return, if published by the Ranking Entity.

\* \* \*

The Institute appreciates this opportunity to comment on these important proposals. If you have any questions regarding our comments, you may contact me at (202) 326-5815, or Dore VanSlyke Zornada at (202) 326-5819.

Sincerely,

Craig S. Tyle

cc: 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.

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

### ENDNOTES

<sup>1</sup> The Investment Company Institute is the national association of the American investment company industry. Its membership includes 7,729 open-end investment companies ("mutual funds"), 485 closed-end investment companies, and 8 sponsors of unit investment trusts. Its mutual fund members have assets of about \$6.010 trillion, accounting for approximately 95% of total industry assets, and have over 78.7 million individual shareholders.

<sup>2</sup> NASDR Notice to Members – Request for Comment 99-79 (September 1999) ("Notice").

<sup>3</sup> It is clear from the rule text that "institutional sales material" is exempt from those standards that apply by their terms only to "advertisements" and "sales literature," which by definition exclude "institutional sales material." However, because the Notice does not discuss which standards apply to "institutional sales material," it may be helpful to clarify in the adopting release which standards apply to "institutional sales material" and which do not.

<sup>4</sup> NASDR also proposes to delete the current specific standards regarding offers of free service, claims for research facilities, hedge clauses, recruiting advertising, and periodic investment plans. We support these proposed deletions and agree that these standards either were unnecessary and/or the issues are adequately addressed by other prohibitions on misleading or imbalanced statements.

<sup>5</sup> NASDR Notice to Members – Request for Comment 98-81 (October 1998); see Letter from Craig S. Tyle, General Counsel, Investment Company Institute, to Ms. Joan Conley, Secretary, NASD Regulation, Inc., dated February 12, 1999 (commenting on NASDR Request for Comment 98-81) ("98-81 Comment Letter").



<sup>6</sup> We also support the proposed exemption from the pre-use approval requirements for form letters and group e-mail to existing retail customers and fewer than 25 prospective retail customers.

<sup>7</sup> The Notice clearly states NASDR's intent to exempt "institutional sales material" from both the pre-use approval and the filing requirements. However, proposed Rule 2210(b)(2)(A) (Approval and Recordkeeping) specifically exempts "institutional sales material" from the pre-use approval requirements while proposed Rule 2210(c) (Filing Requirements and Review Procedures) does not explicitly exempt "institutional sales material" from the filing requirements. For clarity, and to preclude future difficulty in applying the rules, we recommend that proposed Rule 2210(c) be revised to reflect the intent of the proposed amendments and explicitly exempt "institutional sales material" from the filing requirements.

<sup>8</sup> As we have stated previously (see 98-81 Comment Letter, *supra* note 5), Section 24(b) of the Investment Company Act of 1940 requires funds to file sales materials with the SEC within 10 days of use. Rule 24b-3 under the Investment Company Act deems material that is filed with NASDR to be filed with the SEC for this purpose. We reiterate our recommendation that NASDR work with the SEC to accommodate the proposed filing exemptions for institutional and other material; for example, through interpretive or no-action relief.

<sup>9</sup> An example of such guidance is Notice to Members 98-107 regarding disclosure of mutual fund fees and expenses.

<sup>10</sup> Rule 3110(c)(4) defines the term "institutional account" as the account of: (1) a bank, savings and loan, insurance company, or registered investment company; (2) an investment adviser registered with either the SEC or any state; or (3) any other entity or individual with total assets of at least \$50 million.

<sup>11</sup> We note that while proposed Rule 2210(a)(2)(B) specifically includes both member firms and their associated persons, Rule 3110(c)(4) lists certain entities (e.g., banks, insurance companies, and investment advisers) but does not separately refer to individual representatives of those entities. We recommend that NASDR clarify that material provided to such individual representatives would be treated as material provided to the entity.

<sup>12</sup> We believe that trust companies organized under state law should be considered "banks" that would be encompassed by the proposed definition of "institutional investor." While the Conduct Rules do not define the term "bank," Article I(b) of the NASD By-Laws defines "bank" to include, among other entities, "any other banking institution, whether incorporated or not, doing business under the laws of any State or of the United States, a substantial portion of the business of which consists of receiving deposits or exercising fiduciary powers similar to those permitted to national banks under the authority of the Comptroller of the Currency pursuant to the first section of Public Law 87-722 (12 U.S.C. 92a), and which is supervised and examined by a State or Federal authority having supervision over banks, and which is not operated for the purpose of evading the provisions of the Act." NASDR should either clarify that it is appropriate to look to this definition of "bank" for purposes of determining which entities are covered by Conduct Rule 3110(c)(4), or add trust companies organized under state law to the definition of "institutional investor."

<sup>13</sup> NASDR should also consider including other professional designations in the definition of institutional investor that evidence the credential holder's professional competence to provide investment advice or investment advisory services. Like Certified Financial Planners, holders of certain other professional designations undergo training and a difficult examination administered by a professional association in order to receive their credentials, and consequently attain a level of expertise in financial matters that distinguishes them from typical retail investors. The North American Securities Administrators Association (NASAA) recently reviewed the requirements precedent to obtaining sixteen professional designations and determined that the requirements of six of these designations would be at least the equivalent of taking and passing the new Series 65 Uniform Investment Advisor Law Examination. Consequently, NASAA has recommended that states amend their laws to provide an automatic waiver from the Series 65 examination requirement for persons holding any of these six designations: Chartered Investment Counselors (CICs), awarded by the Investment Counsel Association of America, Inc.; Chartered Financial Consultants (ChFCs), awarded by The American College; Personal Financial Specialists (PFSs), awarded by the Specialization Accreditation Board of the American Institute of Certified Public Accountants; and Chartered Financial Analysts (CFAs), awarded by the Association for Investment Management and Research.

<sup>14</sup> We agree with NASDR that the beneficiaries of any qualified retirement plan should receive the same investor protections as other retail investors and that sales material distributed to plan participants should continue to be treated as retail sales material under the NASD advertising rules.

<sup>15</sup> A precedent for establishing such a threshold exists under the Employee Retirement Income Security Act (ERISA). For example, Section 104(a)(2)(A) of ERISA authorizes the Secretary of Labor to prescribe simplified annual reporting requirements "for any pension plan which covers less than 100 participants." Section 103(a)(3)(A) of ERISA utilizes the same threshold to differentiate audit requirements for small versus large plans. In addition, under the Internal Revenue Code, a similar threshold serves as an eligibility requirement for small pension plans (i.e., an employer with no more than 100 employees is eligible to sponsor a SIMPLE plan).

<sup>16</sup> There is precedent under SEC and NASD regulations for using these lower asset thresholds as benchmarks for financial sophistication. For example, the definition of "accredited investor" under Regulation D under the Securities Act of 1933 ("Securities Act") includes certain entities meeting a \$5 million asset threshold. In addition, NASDR has provided guidance to members on their suitability obligations to institutional customers and indicated that this guidance is more appropriately applied to an entity with \$10 million invested in securities in the aggregate in its portfolio and/or under management. See NASD IM-2310-3 "Suitability Obligations to Institutional Customers." While those thresholds apply only to non-natural persons, we recommend that whatever threshold NASDR adopts for these purposes apply equally to entities and natural persons.

We also believe that members should be able to treat as "institutional investors" individuals or entities that reasonably expect to have the requisite amount (e.g., \$5 million or \$10 million) in total assets within 120 days of opening for business. Such a provision would be analogous to Rule 203A-2(d) under the Investment Advisers Act of 1940, which permits a new adviser to register with the SEC if it has a reasonable expectation that, within 120 days of becoming registered, it will have sufficient assets under management to be eligible for SEC registration.

<sup>17</sup> We note that the phrase "materially altered" is capable of varied interpretations and therefore request clarification regarding what NASDR will consider a material alteration in this context. We recommend as examples that members should be able to modify article reprints to: (i) include more recent or standardized performance; (ii) correct inaccuracies or update stale information; or (iii) conform the content of the reprint to NASD content standards, without triggering the filing requirement on the basis that such modifications constitute material alterations. Otherwise, the proposed filing exemption would prove to be of limited utility because members must frequently modify reprints, either directly, or through a separate accompanying statement, to provide additional performance information to satisfy Rule 482 under the Securities Act, update and correct information, or conform the content to meet NASDR standards.

<sup>18</sup> See proposed Rule 2210(c)(8)(H). Article reprints sent to institutional investors also would be exempt from the filing requirements under the proposed amendments because they would be treated as "institutional sales material."

<sup>19</sup> Proposed Rule 2210(d)(1) provides that all communications with the public must be based on principles of fair dealing, and must be fair and balanced. Proposed Rule 2210(d)(2) provides that members may not make false, exaggerated, unwarranted or misleading statements or claims in communications with the public.

<sup>20</sup> See Notice at 582.

<sup>21</sup> See current Rule 2210(d)(1)(D)(iii).

<sup>22</sup> For example, it would add considerable length to advertisements containing rankings if NASDR were to mandate placing in the text of an advertisement information such as that required in proposed IM-2210-3(c)(3), which we understand NASDR has typically permitted members to place in footnotes.

<sup>23</sup> See proposed Rule 2210(d)(5)(B).

<sup>24</sup> See current Rule 2210(d)(2)(M) and proposed Rule 2210(d)(7).

<sup>25</sup> See proposed Rule (c)(8)(G).

<sup>26</sup> See current Rule 2210(d)(1)(C).

<sup>27</sup> Proposed Rule 2210(d)(4) provides that communications with the public "may not predict or project performance, imply that past performance will recur or make any exaggerated or unwarranted claim, opinion or forecast."

<sup>28</sup> While this change would represent a significant improvement, it should be noted that member-organized events often include elements, such as a question and answer session, that can present the same problems noted in the preceding paragraph above.

<sup>29</sup> See Notice at 582-83.

<sup>30</sup> See proposed Rule 2210(c)(3)(A).

<sup>31</sup> See 98-81 Comment Letter, *supra* note 5.

<sup>32</sup> *Id.*

<sup>33</sup> While the Notice indicates that it may take the NASD some time to implement electronic filing of sales material, it should be a relatively easier task for the NASD to provide members with comment letters via e-mail, which we recommend implementing as soon



as possible. This system could include a requirement that members formally designate an e-mail address for this purpose and specifically acknowledge receipt of each e\_mailed comment letter. Sending staff comments via e-mail would vastly increase the speed with which members receive staff comments.

<sup>34</sup> See proposed IM-2210-3 Use of Rankings in Investment Company Advertisements and Sales Literature.

<sup>35</sup> See proposed Rule 2210(a)(3).

<sup>36</sup> Compare current IM-2210-3(d)(2)(B), which requires an investment company ranking based on total return for investment companies in existence for at least ten years to be accompanied by rankings based on total return for one, five and ten year periods if published by the Ranking Entity, and if not, to be accompanied by rankings representing short, medium and long\_term performance, with proposed IM-2210-3(d)(2)(B), which only requires an investment company ranking based on total return to be accompanied by rankings based on total return for short, medium and long term periods.

<sup>37</sup> As provided under the current rule, if the Ranking Entity does not publish rankings based on total return for one, five and ten year time periods, members would be required to use rankings representing short, medium and long\_term performance.

<sup>38</sup> See e.g., SEC Release No. 34-38369 (March 5, 1997); SEC Release No. 34-34354 (July 12, 1994) at 7, 13-14.