

March 9, 2004

Katherine A. England
Assistant Director
Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-1001

Re: File No. SR-NASD-2004-043 - Disclosure of Fees and Expenses in Mutual Fund Performance Sales Material

Dear Ms. England:

Pursuant to Rule 19b-4, enclosed please find the above-numbered rule filing. Also enclosed is a 3-1/2" disk containing the rule filing in Microsoft Word 7.0 to facilitate production of the *Federal Register* release.

If you have any questions, please contact Philip Shaikun, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8451; e-mail philip.shaikun@nasd.com. The fax number of the Office of General Counsel is (202) 728-8264.

Very truly yours,

Barbara Z. Sweeney
Senior Vice President
and Corporate Secretary

Enclosures

File No. SR-NASD-2004-043
Consists of 109 Pages
March 9, 2004

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C.

Form 19b-4

Proposed Rule Change

by

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

Pursuant to Rule 19b-4 under the
Securities Exchange Act of 1934

1. Text of Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”), the National Association of Securities Dealers, Inc. (“NASD”) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change to NASD Rules 2210 and 2211 to require mutual fund communications with the public that provide performance data to disclose the fund’s fees, expenses and standardized performance. These new requirements would improve investor awareness of the costs of buying and owning a mutual fund, facilitate comparisons of funds, and make presentation of standardized performance more prominent. Below is the text of the proposed rule change.

* * * * *

2210. Communications With the Public

(a) through (c) No change.

(d) Content Standards

(1) through (2) No change.

(3) Disclosure of Fees, Expenses and Standardized Performance

(A) Communications with the public, other than institutional sales material and public appearances, that present non-money market fund open-end management investment company performance data as permitted by Rule 482 under the Securities Act of 1933 and Rule 34b-1 under the Investment Company Act of 1940 must disclose:

(i) the standardized performance information mandated by Rule 482 and Rule 34b-1; and

(ii) to the extent applicable:

(a) the maximum sales charge imposed on purchases or the maximum deferred sales charge, as stated in the investment company's prospectus current as of the date of submission of an advertisement for publication, or as of the date of distribution of other communications with the public; and

(b) annual fund operating expenses, as stated in the investment company's prospectus described in paragraph

(a).

(B) All of the information required by paragraph (A) must be set forth:

(i) clearly and prominently, and standardized performance information must be in a type size that is at least as large as that used to present any nonstandardized performance;

(ii) with respect to any radio, television or video advertisement, with equal emphasis to that given to any nonstandardized performance; and

(iii) in any advertisement other than a radio, television or video advertisement, in a prominent text box that contains only the required information.

(e) No change.

* * * * *

2211. Institutional Sales Material and Correspondence

(a) through (c) No change.

(d) Content Standards Applicable to Institutional Sales Material and Correspondence

(1) All institutional sales material and correspondence are subject to the content standards of Rule 2210(d)(1) and the applicable Interpretive Materials under Rule 2210, and all correspondence is subject to the content standards of paragraph (d)(3).

(2) through (3) No change.

* * * * *

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

(a) The proposed rule change was approved by the Board of Directors of NASD Regulation, Inc. at its meeting on November 13, 2003, which authorized the issuance of a Notice to Members and the filing of the proposed rule change with the SEC. Counsel for The Nasdaq Stock Market and NASD Dispute Resolution have been provided an opportunity to consult with respect to the proposed rule change, pursuant to the Plan of Allocation and Delegation of Functions by NASD to its Subsidiaries. The NASD Board of Governors had an opportunity to review the proposed rule change at its meeting on November 14, 2003. No other action by NASD is necessary for the filing of the proposed rule change. Section 1(a)(ii) of Article VII of the NASD By-Laws permits the NASD

Board of Governors to adopt amendments to NASD Rules without recourse to the membership for approval.

NASD will announce the effective date of the proposed rule change in a Notice to Members to be published no later than 60 days following Commission approval. The effective date will be 30 days following publication of the Notice to Members announcing Commission approval.

3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) Purpose

NASD proposes to amend Rules 2210 and 2211 to require member communications with the public, other than institutional sales material and public appearances, that present mutual fund performance information to disclose the fund's fees, expenses and standardized performance. These new requirements would improve investor awareness of the costs of buying and owning a mutual fund, facilitate comparison of funds and make the presentation of standardized performance more prominent. The proposed rule change would require that:

- Performance sales material disclose the fees and expenses associated with purchase and ownership of the fund, derived from the fund's most recent prospectus and stated as a percentage of net assets;
- Performance sales material disclose the standardized performance of the mutual fund, as prescribed in SEC Rules 482 and 34b-1; and
- Advertisements (other than radio, television or video advertisements) present the required disclosure in a prominent text box.

(b) Statutory Basis

The proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that NASD's rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and to protect investors and the public interest. The proposed rule change will enhance investor protection by making more transparent the true costs of purchasing and owning a mutual fund and providing useful information on which to base investment decisions.

4. Self-Regulatory Organization's Statement on Burden on Competition

The proposed rule change will not result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

The proposed rule change was published for comment in NASD Notice to Members 03-77 (the "NtM"). NASD received 11 comments in response to the NtM. A copy of the NtM is attached as Exhibit 2. Copies of the comment letters received in response to the NtM are attached as Exhibit 3. Of the 11 comment letters received, six supported the proposed rule change, and five opposed it.

Some commenters asserted that the proposed rule change would confuse investors or is otherwise unnecessary.¹ One commenter argued that NASD should not adopt the proposed rule change because its greatest impact would be on directly-marketed mutual

¹ Letter from the Securities Industry Association (January 22, 2004) ("SIA"); letter from Sherrets & Boecker LLC (January 27, 2004) ("Sherrets & Boecker").

funds and the lowest-cost funds, despite the fact that most funds are broker-sold.² T. Rowe Price suggested that the disclosure requirements should apply only to funds with expense ratios above the average for their category.

SEC Rules 482 and 34b-1 already require disclosure of a broker-sold fund's sales load in performance sales material. The proposed rule change also would require the disclosure of the fund's expense ratio in performance sales material, whether the sales material is distributed by a full-service broker/dealer, a discount broker/dealer, or the underwriter for a directly-marketed fund. Moreover, NASD finds no convincing rationale why lower-cost or directly-marketed funds should object to the proposed presentation of their expense ratios. Indeed, several no-load and directly-marketed mutual fund complexes supported the proposed rule change.³

Some commenters also asserted that the proposed rule change would invite investors to pay undue attention to a fund's performance.⁴ NASD finds this argument to be without merit. As these commenters surely are aware, performance sales material, especially advertisements, by their nature seek to focus an investor's attention on a fund's historical performance. The proposed rule change would simply balance this emphasis on performance with disclosure concerning the fund's fees and expenses. In addition, the proposed rule change would better ensure that standardized performance is presented in a clear and prominent manner.

² See letter from T. Rowe Price Investment Services, Inc. (January 23, 2004) ("T. Rowe Price").

³ See letter from Fidelity Investments (January 23, 2004) ("Fidelity"); letter from The Vanguard Group (January 22, 2004) ("Vanguard").

⁴ See Fidelity; SIA; letter from Oppenheimer Funds Distributor, Inc., (January 23, 2004) ("Oppenheimer").

Some commenters opposed the requirement that the required disclosure appear in a prominent text box.⁵ These commenters especially objected to the imposition of such a requirement in sales literature, such as fund fact sheets and brochures concerning a family of funds. The proposed text box would facilitate the ability of any investor to compare expense information for different funds. Nevertheless, in order to balance this advantage with the practical concerns raised by commenters, the proposed rule change has been amended to impose the text box requirement only on advertisements as defined by Rule 2210.⁶ Some commenters also objected to application of the text box requirement to advertisements for multiple funds.⁷ While application of the requirement to these advertisements may present practical concerns, the advantages of the text box requirement outweigh the burdens of designing advertisements for multiple funds in a compliant manner.⁸

The NtM requested comment on whether the proposed rule change should require disclosure of the dollar amount of expenses incurred by a hypothetical shareholder in the

⁵ See T. Rowe Price; letter from the Investment Company Institute (January 23, 2004) (“ICI”).

⁶ Rule 2210 defines “advertisement” as “any material, other than an independently prepared reprint and institutional sales material, that is published, or used in any electronic or other public media, including any Web site, newspaper, magazine or other periodical, radio, television, telephone or tape recording, videotape display, signs or billboards, motion pictures, or telephone directories (other than routine listings).”

⁷ *See, e.g.*, ICI.

⁸ The ICI also asserts that the sample disclosure attached to the NtM fails to comply with the proposed requirement that the text box include no information other than the required disclosure. ICI refers to the statement in the sample disclosure that the performance numbers reflect the deduction of sales charges and annual expenses. As the ICI is aware, mutual fund sales material is subject to a filing requirement under Rule 2210 and the exclusivity requirement would be a matter for review. At the outset, however, it can be said that the exclusivity requirement would not preclude the use of such language, which merely states that the disclosed performance data reflects the disclosed fees and expenses.

fund. Commenters generally opposed such an approach.⁹ It appears that in order to adopt such an approach NASD either would have to require disclosure of dollar amounts based on the actual returns of a fund, in which case a fund with superior returns would disclose higher expenses, or base the dollar amounts on an assumed rate of return (e.g., 0 percent or 5 percent). An assumed rate of return in sales material could confuse or mislead investors, by either understating the actual dollar amount of expenses or by indicating that the fund may attain a specified performance. For that reason NASD has determined not to amend the proposed rule change in this manner.

Several commenters recommended that the proposed rule change not apply to institutional sales material, in light of the sophistication and expertise of institutional investors.¹⁰ NASD has amended the proposed rule change accordingly. NASD also has excluded public appearances and communications with the public regarding money market funds from the proposed rule change.

Some commenters recommended that the proposed rule change require disclosure of fund expenses as calculated in Item 9 of Form N-1A, rather than Item 3.¹¹ Item 3 establishes the standards for calculating fees and expenses for purposes of the prospectus fee table, while Item 9 imposes the standards for calculation of fees and expenses for purpose of shareholder reports. The principal difference between the two forms of calculation is that the expenses calculated under Item 3 generally may not reflect the effect

⁹ See, e.g., T. Rowe Price; ICI.

¹⁰ See ICI; Fidelity; Vanguard; Oppenheimer.

¹¹ See ICI; Fidelity; Vanguard.

of fee waivers and expense reimbursements, while those calculated according to Item 9 may reflect these waivers and reimbursements. The prospective purchaser is better informed with disclosure of fees and expenses that do not reflect fee waivers and expense reimbursements, which may be subject to future termination. Consequently, NASD has amended the proposed rule change to require fee and expense disclosure derived from the most recent prospectus.¹²

Some commenters objected to the proposed requirement that the disclosure of fund expenses be current as of the most recent calendar quarter.¹³ The new requirement that the information be derived from the most recent prospectus should address this concern.

Vanguard requested that NASD adopt a “one click away” rule for the depiction of the required disclosure in electronic communications. Under this approach, an investor could click on a hyperlink in close proximity to nonstandardized performance in order to obtain the required disclosure. In its recent amendments to Rule 482, the SEC rejected a “one-click away” rule for performance-related disclosures required by paragraph (b)(3).¹⁴ NASD similarly has determined that broker/dealers should not rely on a “one click away” rule for the disclosure of information that would be required by the proposed rule change. NASD also has amended the proposed rule change to clarify the disclosure standards applicable to different forms of sales material.

¹² The proposed rule change would not preclude members from including additional information regarding fee waivers and expense reimbursements, outside the text box in the case of advertisements.

¹³ See ICI; Fidelity; Vanguard.

¹⁴ See SEC Release No. 33-8294 (Sept. 29, 2003), 68 Fed. Reg. 57760, 57767 (Oct. 6, 2003).

The NtM would have provided that the required disclosure be in a type size at least as large as that of the nonstandardized performance. The ICI requested that the proposed rule change instead require that the type size of the required information be at least as large as that used in the major part of a print advertisement. A purpose of the proposed rule change is to require fee, expense and standardized performance disclosure that will balance the nonstandardized performance. In order to meet this particular purpose, NASD has revised the proposal to require that all disclosure be set forth clearly and prominently, and to require that disclosure of standardized performance be in a type size at least as large as that of the nonstandardized performance.

NASD also has amended the proposed rule change to clarify certain other disclosure requirements. We have eliminated the provision that allows communications delivered through an electronic medium to present the disclosure “in a manner that is intended to draw investor attention to it.” Upon further consideration we have determined that this standard may be too vague. Under the proposed rule change as amended, Web sites would have to comply with the prominent text box and type size requirements and radio, television and video advertisements would have to provide the required disclosure “with equal emphasis” to that given to any nonstandardized performance.

Some commenters also requested that NASD amend the proposed rule change to require disclosure of the “maximum deferred sales charge” rather than the “maximum *contingent* deferred sales charge,” and to clarify that disclosure of the maximum front-end

or deferred sales charge is required only to the extent that the fund imposes such a charge.¹⁵ NASD has amended the proposed rule change accordingly.

Two commenters requested clarification of whether the proposed rule change would apply to variable annuity sales material.¹⁶ NASD has amended the proposed rule change to clarify that it would only apply to open-end management investment companies.

6. Extension of Time Period for Commission Action

NASD does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

Not applicable.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Exhibits

1. Completed notice of proposed rule change for publication in the Federal Register.

2. NASD Notice to Members 03-77.

3. Comments received in response to NASD Notice to Members 03-77.

¹⁵ ICI; Fidelity.

¹⁶ See letter from Northwestern Mutual Investment Services (January 23, 2004) (opposing application of the proposed rule change to variable products); e-mail message from Brian Wilkerson, Nations Financial Group, Inc. (December 11, 2003).

Pursuant to the requirements of the Securities Exchange Act of 1934, NASD has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

NASD, INC.

BY: _____
Barbara Z. Sweeney, Senior Vice President and
Corporate Secretary

Date: March 9, 2004

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-NASD-2004-043)

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to Disclosure of Fees and Expenses in Mutual Fund Performance Sales Material

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on March 9, 2004, the National Association of Securities Dealers, Inc. (“NASD”), filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. SELF-REGULATORY ORGANIZATION'S STATEMENT OF THE TERMS OF SUBSTANCE OF THE PROPOSED RULE CHANGE

NASD is proposing to amend Rules 2210 and 2211 of NASD to require mutual fund communications with the public that provide performance data to disclose the fund’s fees, expenses and standardized performance. Below is the text of the proposed rule change. Proposed new language is in italics; proposed deletions are in brackets.

* * * * *

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

2210. Communications With the Public

(a) through (c) No change.

(d) Content Standards

(1) through (2) No change.

(3) Disclosure of Fees, Expenses and Standardized Performance

(A) Communications with the public, other than institutional sales material and public appearances, that present non-money market fund open-end management investment company performance data as permitted by Rule 482 under the Securities Act of 1933 and Rule 34b-1 under the Investment Company Act of 1940 must disclose:

(i) the standardized performance information mandated by Rule 482 and Rule 34b-1; and

(ii) to the extent applicable:

(a) the maximum sales charge imposed on purchases or the maximum deferred sales charge, as stated in the investment company's prospectus current as of the date of submission of an advertisement for publication, or as of the date of distribution of other communications with the public; and

(b) annual fund operating expenses, as stated in the investment company's prospectus described in paragraph

(a).

(B) All of the information required by paragraph (A) must be set forth:

(i) clearly and prominently, and standardized performance

information must be in a type size that is at least as large as that used to present any nonstandardized performance;

(ii) with respect to any radio, television or video advertisement,

with equal emphasis to that given to any nonstandardized performance; and

(iii) in any advertisement other than a radio, television or video

advertisement, in a prominent text box that contains only the required information.

(e) No change.

* * * * *

2211. Institutional Sales Material and Correspondence

(a) through (c) No change.

(d) Content Standards Applicable to Institutional Sales Material and Correspondence

(1) All institutional sales material and correspondence are subject to the content standards of Rule 2210(d)(1) and the applicable Interpretive Materials under Rule 2210, and all correspondence is subject to the content standards of paragraph (d)(3).

(2) through (3) No change.

* * * * *

II. SELF-REGULATORY ORGANIZATION'S STATEMENT OF THE PURPOSE OF, AND STATUTORY BASIS FOR, THE PROPOSED RULE CHANGE

In its filing with the Commission, NASD included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. NASD has prepared summaries, set forth in Sections (A), (B), and (C) below, of the most significant aspects of such statements.

(A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

NASD proposes to amend Rules 2210 and 2211 to require member communications with the public, other than institutional sales material, that present mutual fund performance information to disclose the fund's fees, expenses and standardized performance. These new requirements would improve investor awareness of the costs of buying and owning a mutual fund, facilitate comparison of funds and make the presentation of standardized performance more prominent. The proposed rule change would require that:

- Performance sales material disclose the fees and expenses associated with purchase and ownership of the fund, derived from the fund's most recent prospectus and stated as a percentage of net assets;
- Performance sales material disclose the standardized performance of the mutual fund, as prescribed in SEC Rules 482 and 34b-1; and

- Advertisements (other than radio, television or video advertisements) present the required disclosure in a prominent text box.

2. Statutory Basis

The proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that NASD's rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and to protect investors and the public interest. The proposed rule change will enhance investor protection by making more transparent the true costs of purchasing and owning a mutual fund and providing useful information on which to base investment decisions.

(B) Self-Regulatory Organization's Statement on Burden on Competition

NASD does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

(C) Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

The proposed rule change was published for comment in NASD Notice to Members 03-77 (the "NtM"). NASD received 11 comments in response to the NtM. Of the 11 comment letters received, six supported the proposed rule change, and five opposed it.

Some commenters asserted that the proposed rule change would confuse investors or is otherwise unnecessary.³ One commenter argued that NASD should not adopt the proposed rule change because its greatest impact would be on directly-marketed mutual funds and the lowest-cost funds, despite the fact that most funds are broker-sold.⁴ T. Rowe Price suggested that the disclosure requirements should apply only to funds with expense ratios above the average for their category.

SEC Rules 482 and 34b-1 already require disclosure of a broker-sold fund's sales load in performance sales material. The proposed rule change also would require the disclosure of the fund's expense ratio in performance sales material, whether the sales material is distributed by a full-service broker/dealer, a discount broker/dealer, or the underwriter for a directly-marketed fund. Moreover, NASD finds no convincing rationale why lower-cost or directly-marketed funds should object to the proposed presentation of their expense ratios. Indeed, several no-load and directly-marketed mutual fund complexes supported the proposed rule change.⁵

Some commenters also asserted that the proposed rule change would invite investors to pay undue attention to a fund's performance.⁶ NASD finds this argument to be without merit. As these commenters surely are aware, performance sales material,

³ Letter from the Securities Industry Association (January 22, 2004) ("SIA"); letter from Sherrets & Boecker LLC (January 27, 2004) ("Sherrets & Boecker").

⁴ See letter from T. Rowe Price Investment Services, Inc. (January 23, 2004) ("T. Rowe Price").

⁵ See letter from Fidelity Investments (January 23, 2004) ("Fidelity"); letter from The Vanguard Group (January 22, 2004) ("Vanguard").

⁶ See Fidelity; SIA; letter from Oppenheimer Funds Distributor, Inc., (January 23, 2004) ("Oppenheimer").

especially advertisements, by their nature seek to focus an investor's attention on a fund's historical performance. The proposed rule change would simply balance this emphasis on performance with disclosure concerning the fund's fees and expenses. In addition, the proposed rule change would better ensure that standardized performance is presented in a clear and prominent manner.

Some commenters opposed the requirement that the required disclosure appear in a prominent text box.⁷ These commenters especially objected to the imposition of such a requirement in sales literature, such as fund fact sheets and brochures concerning a family of funds. The proposed text box would facilitate the ability of any investor to compare expense information for different funds. Nevertheless, in order to balance this advantage with the practical concerns raised by commenters, the proposed rule change has been amended to impose the text box requirement only on advertisements as defined by Rule 2210.⁸ Some commenters also objected to application of the text box requirement to advertisements for multiple funds.⁹ While application of the requirement to these advertisements may present practical concerns, the advantages of the text box requirement

⁷ See T. Rowe Price; letter from the Investment Company Institute (January 23, 2004) ("ICI").

⁸ Rule 2210 defines "advertisement" as "any material, other than an independently prepared reprint and institutional sales material, that is published, or used in any electronic or other public media, including any Web site, newspaper, magazine or other periodical, radio, television, telephone or tape recording, videotape display, signs or billboards, motion pictures, or telephone directories (other than routine listings)."

⁹ See, e.g., ICI.

outweigh the burdens of designing advertisements for multiple funds in a compliant manner.¹⁰

The NtM requested comment on whether the proposed rule change should require disclosure of the dollar amount of expenses incurred by a hypothetical shareholder in the fund. Commenters generally opposed such an approach.¹¹ It appears that in order to adopt such an approach NASD either would have to require disclosure of dollar amounts based on the actual returns of a fund, in which case a fund with superior returns would disclose higher expenses, or base the dollar amounts on an assumed rate of return (e.g., 0 percent or 5 percent). An assumed rate of return in sales material could confuse or mislead investors, by either understating the actual dollar amount of expenses or by indicating that the fund may attain a specified performance. For that reason NASD has determined not to amend the proposed rule change in this manner.

Several commenters recommended that the proposed rule change not apply to institutional sales material, in light of the sophistication and expertise of institutional investors.¹² NASD has amended the proposed rule change accordingly. NASD also has excluded public appearances and communications with the public regarding money market funds from the proposed rule change.

¹⁰ The ICI also asserts that the sample disclosure attached to the NtM fails to comply with the proposed requirement that the text box include no information other than the required disclosure. ICI refers to the statement in the sample disclosure that the performance numbers reflect the deduction of sales charges and annual expenses. As the ICI is aware, mutual fund sales material is subject to a filing requirement under Rule 2210 and the exclusivity requirement would be a matter for review. At the outset, however, it can be said that the exclusivity requirement would not preclude the use of such language, which merely states that the disclosed performance data reflects the disclosed fees and expenses.

¹¹ See T. Rowe Price; ICI.

Some commenters recommended that the proposed rule change require disclosure of fund expenses as calculated in Item 9 of Form N-1A, rather than Item 3.¹³ Item 3 establishes the standards for calculating fees and expenses for purposes of the prospectus fee table, while Item 9 imposes the standards for calculation of fees and expenses for purpose of shareholder reports. The principal difference between the two forms of calculation is that the expenses calculated under Item 3 generally may not reflect the effect of fee waivers and expense reimbursements, while those calculated according to Item 9 may reflect these waivers and reimbursements. The prospective purchaser is better informed with disclosure of fees and expenses that do not reflect fee waivers and expense reimbursements, which may be subject to future termination. Consequently, NASD has amended the proposed rule change to require fee and expense disclosure derived from the most recent prospectus.¹⁴

Some commenters objected to the proposed requirement that the disclosure of fund expenses be current as of the most recent calendar quarter.¹⁵ The new requirement that the information be derived from the most recent prospectus should address this concern.

Vanguard requested that NASD adopt a “one click away” rule for the depiction of the required disclosure in electronic communications. Under this approach, an investor

¹² See ICI; Fidelity; Vanguard; Oppenheimer.

¹³ See ICI; Fidelity; Vanguard.

¹⁴ The proposed rule change would not preclude members from including additional information regarding fee waivers and expense reimbursements, outside the text box in the case of advertisements.

¹⁵ See ICI; Fidelity; Vanguard.

could click on a hyperlink in close proximity to nonstandardized performance in order to obtain the required disclosure. In its recent amendments to Rule 482, the SEC rejected a “one-click away” rule for performance-related disclosures required by paragraph (b)(3).¹⁶ NASD similarly has determined that broker/dealers should not rely on a “one click away” rule for the disclosure of information that would be required by the proposed rule change. NASD also has amended the proposed rule change to clarify the disclosure standards applicable to different forms of sales material.

The NtM would have provided that the required disclosure be in a type size at least as large as that of the nonstandardized performance. The ICI requested that the proposed rule change instead require that the type size of the required information be at least as large as that used in the major part of a print advertisement. A purpose of the proposed rule change is to require fee, expense and standardized performance disclosure that will balance the nonstandardized performance. In order to meet this particular purpose, NASD has revised the proposal to require that all disclosure be set forth clearly and prominently, and to require that disclosure of standardized performance be in a type size at least as large as that of the nonstandardized performance.

NASD also has amended the proposed rule change to clarify certain other disclosure requirements. We have eliminated the provision that allows communications delivered through an electronic medium to present the disclosure “in a manner that is intended to draw investor attention to it.” Upon further consideration we have determined that this standard may be too vague. Under the proposed rule change as amended, Web

¹⁶ See SEC Release No. 33-8294 (Sept. 29, 2003), 68 Fed. Reg. 57760, 57767 (Oct. 6, 2003).

sites would have to comply with the prominent text box and type size requirements and radio, television and video advertisements would have to provide the required disclosure “with equal emphasis” to that given to any nonstandardized performance.

Some commenters also requested that NASD amend the proposed rule change to require disclosure of the “maximum deferred sales charge” rather than the “maximum *contingent* deferred sales charge,” and to clarify that disclosure of the maximum front-end or deferred sales charge is required only to the extent that the fund imposes such a charge.¹⁷ NASD has amended the proposed rule change accordingly.

Two commenters requested clarification of whether the proposed rule change would apply to variable annuity sales material.¹⁸ NASD has amended the proposed rule change to clarify that it would only apply to open-end management investment companies.

III. DATE OF EFFECTIVENESS OF THE PROPOSED RULE CHANGE AND TIMING FOR COMMISSION ACTION

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

A. by order approve such proposed rule change, or

B. institute proceedings to determine whether the proposed rule change should be disapproved.

¹⁷ ICI; Fidelity.

¹⁸ See letter from Northwestern Mutual Investment Services (January 23, 2004) (opposing application of the proposed rule change to variable products); e-mail message from Brian Wilkerson, Nations Financial Group, Inc. (December 11, 2003).

IV. SOLICITATION OF COMMENTS

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. Comments may also be submitted electronically at the following e-mail address: rule-comments@sec.gov. All comment letters should refer to File No. SR-NASD-2004-043. This file number should be included on the subject line if e-mail is used. To help us process and review comments more efficiently, comments should be sent in hardcopy or by e-mail but not by both methods. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of NASD. All submissions should refer to the file number in the caption above and should be submitted by [insert date 21 days from the date of publication].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority, 17 CFR 200.30-3(a)(12).

Margaret H. McFarland
Deputy Secretary