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February 26, 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-2003-013 – Amendment No. 3 to Proposed Interpretive Material Regarding the Use of Investment Analysis Tools

Dear Ms. England:

NASD hereby submits Amendment No. 3 to SR-NASD-2003-013 (Attachment A), regarding NASD's proposed Interpretive Material ("IM") for member firms' use of "investment analysis tools."¹ NASD is amending the proposal to clarify certain provisions at the request of the Securities and Exchange Commission ("SEC") staff. The changes made by Amendment No. 3 are briefly described below. NASD also hereby grants the SEC staff's request for a 30-day extension of time to consider the proposal.

By means of this Amendment, NASD is highlighting in the proposed IM a discussion of regulatory requirements, as shown below, by moving the discussion and making it a standalone paragraph (rather than simply having the discussion appear as part of a larger paragraph). NASD also is adding a number of specific references to NASD and SEC rules and requirements to that same discussion/paragraph, which now states as follows:²

¹ On February 27, 2003, NASD filed with the SEC NASD's Amendment No. 1, which completely replaced and superseded the original proposed IM. The SEC published Amendment No. 1 for comment in the *Federal Register* on April 3, 2003. See Notice of Filing of Proposed Rule Change and Amendment No. 1 by NASD Relating to Proposed Interpretive Material Regarding the Use of Investment Analysis Tools, Release No. 34-47590 (Mar. 28, 2003) (SR-NASD-2003-013), 68 FR 16325 (April 3, 2003). The comment period closed on April 24, 2003. *Id.* at 16328. NASD notes that Amendment No. 1 merely made a technical change to the original proposed IM. The original proposed IM was not published for comment in the *Federal Register*.

Seven commenters submitted letters in response to the SEC's publication of Amendment No. 1. All of the commenters were generally supportive of allowing member firms to use and provide customers access to investment analysis tools. Some commenters, however, requested that NASD modify the proposed IM in certain respects. By letter dated December 2, 2003, NASD responded to the comment letters and submitted Amendment No. 2 to SR-NASD-2003-013. As discussed more fully in NASD's letter of December 2, 2003, Amendment No. 2 streamlined certain requirements and clarified others in response to various commenters' concerns. Amendment No. 2 also modified the proposed IM to make it consistent with recently approved changes to NASD's advertising rules.

² The base rule text is that of Amendment No. 2. The proposed revised rule language of Amendment No. 3 is underlined and the deleted text of Amendment No. 2 is in brackets.

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[In addition, a]As in all cases, a member's compliance with this Interpretive Material does not mean that the member is acting in conformity with other applicable laws and rules. A member that offers an investment analysis tool under this Interpretive Material (whether customers use the member's tool independently or with assistance from the member) is responsible for ensuring that use of the investment analysis tool and all recommendations based on the investment analysis tool (whether made via the automated tool or a written report) comply, as applicable, with NASD's suitability rule (Rule 2310), the other provisions of Rule 2210 (including, but not limited to, the principles of fair dealing and good faith, [and] the prohibition on exaggerated, unwarranted or misleading statements or claims, and any other applicable filing requirements for advertisements and sales literature), the federal securities laws (including, but not limited to, the antifraud provisions), the Securities and Exchange Commission rules (including, but not limited to, SEC Rule 156 under the Securities Act of 1933) and other NASD rules.

Amendment No. 3 to SR-NASD-2003-013 (Attachment A) is the new proposed rule text, incorporating all amendments made to the proposed IM to date. If you wish to discuss this matter further, please feel free to contact me at 202-728-8270 or Patrice Gliniecki, Senior Vice President and Deputy General Counsel, at 202-728-8014.

Very truly yours,

James S. Wrona

cc: Joseph Morra, Esq.
Division of Market Regulation
Securities and Exchange Commission

Attachment

**Amendment No. 3 to SR-NASD-2003-013
Proposed IM-2210-6 – Investment Analysis Tools**

IM-2210-6. Requirements for the Use of Investment Analysis Tools

(a) General Considerations

This Interpretive Material provides a limited exception to NASD Rule 2210(d)(1)(D).¹ No member may imply that NASD endorses or approves the use of any investment analysis tool or any recommendation based on such a tool. A member that offers or intends to offer an investment analysis tool under this Interpretive Material (whether customers use the member's tool independently or with assistance from the member) must, within 10 days of first use, (1) provide NASD's Advertising Regulation Department (Department) access to the investment analysis tool and (2) file with the Department any template for written reports produced by, or sales material concerning, the tool.² The member also must provide any supplemental information requested by the Department. The Department may require that the member modify the investment analysis tool, written-report template or sales material. The Department also may

¹ NASD Rule 2210(d)(1)(D) states that "[c]ommunications 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." This Interpretive Material allows member firms to offer investment analysis tools (whether customers use the member's tool independently or with assistance from the member), written reports indicating the results generated by such tools and related sales material in certain circumstances.

Rule 2210(d)(1)(D) does not prohibit, and this Interpretive Material does not apply to, hypothetical illustrations of mathematical principles that do not predict or project the performance of an investment or investment strategy.

² After the Department has reviewed the investment analysis tool, written-report template or sales material, a member must notify the Department and provide additional access to the tool and re-file any template or sales material if it makes a material change to the presentation of information or disclosures as required by paragraphs (c) and (d).

require that the member not offer or continue to offer or use the tool, written-report template or sales material until all changes specified by the Department have been made by the member.

A member that offers an investment analysis tool exclusively to "institutional investors," as defined in Rule 2211(a)(3), is not subject to the post-use access and filing requirement in this paragraph if the communications relating to or produced by the tool meet the criteria for "institutional sales material," as defined in Rule 2211(a)(2). A member that intends to make the tool available to, or that intends to use the tool with, any person other than an institutional investor (such as an employee benefit plan participant or a retail broker-dealer customer) will be subject to the filing and access requirements, however.

As in all cases, a member's compliance with this Interpretive Material does not mean that the member is acting in conformity with other applicable laws and rules. A member that offers an investment analysis tool under this Interpretive Material (whether customers use the member's tool independently or with assistance from the member) is responsible for ensuring that use of the investment analysis tool and all recommendations based on the investment analysis tool (whether made via the automated tool or a written report) comply, as applicable, with NASD's suitability rule (Rule 2310), the other provisions of Rule 2210 (including, but not limited to, the principles of fair dealing and good faith, the prohibition on exaggerated, unwarranted or misleading statements or claims, and any other applicable filing requirements for advertisements and sales literature), the federal securities laws (including, but not limited to, the antifraud provisions), the Securities and Exchange Commission rules (including, but not limited to, SEC Rule 156 under the Securities Act of 1933) and other NASD rules.

(b) Definition

For purposes of this Interpretive Material and any interpretation thereof, an "investment analysis tool" is an interactive technological tool that produces simulations and statistical

analyses that present the likelihood of various investment outcomes if certain investments are made or certain investment strategies or styles are undertaken, thereby serving as an additional resource to investors in the evaluation of the potential risks and returns of investment choices.

(c) Use of Investment Analysis Tools and Related Written Reports and Sales

Material

A member may provide an investment analysis tool (whether customers use the member's tool independently or with assistance from the member), written reports indicating the results generated by such tool and related sales material³ only if:

- (1) the member describes the criteria and methodology used, including the investment analysis tool's limitations and key assumptions;
- (2) the member explains that results may vary with each use and over time;
- (3) if applicable, the member describes the universe of investments considered in the analysis, explains how the tool determines which securities to select, discloses if the tool favors certain securities and, if so, explains the reason for the selectivity,⁴ and states that other investments not considered may have characteristics similar or superior to those being analyzed; and
- (4) the member displays the following additional disclosure: "IMPORTANT:
The projections or other information generated by [name of investment analysis tool]"

³ Sales material that contains only an incidental reference to an investment analysis tool (e.g., a brochure that merely mentions a member's tool as one of the services offered by the member) need not include the disclosures required by this Interpretive Material and would not need to be filed with the Department, unless otherwise required by the other provisions of Rule 2210.

⁴ This disclosure must indicate, among other things, whether the investment analysis tool searches, analyzes or in any way favors certain securities within the universe of securities considered based on revenue received by the member in connection with the sale of those securities or based on relationships or understandings between the member and the entity that created the investment analysis tool. The disclosure also must indicate whether the investment analysis tool is limited to searching, analyzing or in any way favoring securities in which the member makes a market or has any other direct or indirect interest. Members are not required to provide a "negative" disclosure (i.e., a disclosure indicating that the tool does *not* favor certain securities).

regarding the likelihood of various investment outcomes are hypothetical in nature, do not reflect actual investment results and are not guarantees of future results."

(d) Disclosures

The disclosures and other required information discussed in paragraph (c) must be clear and prominent and must be in written or electronic narrative form.