

INFORMATIONAL

Bond Mutual Fund Volatility Ratings

Rules Relating To Bond Mutual Fund Volatility Ratings Extended Two Years

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KEY TOPICS

- Bond Mutual Fund Volatility Ratings
- NASD IM-2210-5
- NASD Rule 2210

Executive Summary

On August 10, 2001, the effectiveness of the National Association of Securities Dealers, Inc. (NASD[®]) rules that govern the use of bond mutual fund volatility ratings in member sales material was extended until August 31, 2003. NASD IM-2210-5 permits members and associated persons to include bond mutual fund volatility ratings in supplemental sales literature, subject to certain conditions. NASD Rule 2210(c)(3) requires supplemental sales literature containing bond mutual fund volatility ratings to be filed with the Advertising Regulation Department (the Department) for review and approval at least 10 days prior to use.

The Securities and Exchange Commission (SEC) originally approved IM-2210-5 and 2210(c)(3) on an interim 18-month pilot basis, which period was to expire on August 31, 2001. NASD Regulation, Inc. (NASD RegulationSM) proposed that the pilot period be extended an additional two years, until August 31, 2003. Pursuant to SEC rules, the proposal was effective immediately upon filing.

Included with this *Notice* is Attachment A (text of rule amendments).

Questions/Further Information

Questions or comments concerning this *Notice* may be directed to Thomas M. Selman, Senior Vice President, Investment Companies/Corporate Financing, NASD Regulation, at (240) 386-4533; Joseph P. Savage, Counsel, Investment Companies Regulation, NASD Regulation, at (240) 386-4534; or Sarah J. Williams, Assistant General

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Background

On February 29, 2000, the SEC approved the adoption of NASD Interpretive Material 2210-5, which permits members and their associated persons to include bond mutual fund volatility ratings in supplemental sales literature (mutual fund sales material that is accompanied or preceded by a fund prospectus). The SEC also approved at that time new NASD Rule 2210(c)(3), which sets forth the filing requirements and review procedures applicable to sales literature containing bond mutual fund volatility ratings. Previously, the NASD Regulation staff interpreted NASD rules to prohibit the use of bond mutual fund volatility ratings in sales material.

IM-2210-5 permits the use of bond mutual fund volatility ratings only in supplemental sales literature and only if certain conditions are met:

- The word "risk" may not be used to describe the rating.
- The rating must be the most recent available and be current to the most recent calendar quarter ended prior to use.
- The rating must be based exclusively on objective, quantifiable factors.
- The entity issuing the rating must provide detailed disclosure on its rating methodology to investors through a toll-free telephone number, a Web site, or both.
- A disclosure statement containing all of the information required by the rule must accompany the rating. The statement must

include such information as the name of the entity issuing the rating, the most current rating and the date it was issued, and a description of the rating in narrative form containing certain specified disclosures.

Rule 2210(c)(3) requires members to file bond mutual fund sales literature that includes or incorporates volatility ratings with the Department at least 10 days prior to use for Department approval. If the Department requests changes to the material, the material must be withheld from publication or circulation until the requested changes have been made or the material has been re-filed and approved. For a more complete description of IM-2210-5 and Rule 2210(c)(3), please see *NASD Notice to Members 00-23* (April 2000).

Extension Of Trial Period

The SEC originally approved IM-2210-5 and the new Rule 2210(c)(3) on an 18-month trial basis, which trial period was scheduled to expire on August 31, 2001, unless extended or permanently approved by the NASD at or before that date. NASD Regulation requested the 18-month trial period to provide an opportunity to assess whether the rule had facilitated the dissemination of useful, understandable information to investors, and whether it had prevented the dissemination of inappropriate and misleading information.

The Department has received very few filings pursuant to these provisions. In general, these filings have met the requirements of IM-2210-5. However, the staff does not believe that it has received a sufficient number of filings to evaluate adequately the rule's effectiveness. The staff believes that additional experience with the rule is necessary to evaluate adequately its effect on the delivery of accurate and useful information to investors concerning bond mutual fund volatility.

Accordingly, NASD Regulation is extending the expiration date of IM-2210-5 and Rule 2110(c)(3) for an additional two years, until August 31, 2003, to allow more filings to be made. Before this period expires, the NASD Regulation staff will evaluate the rule and determine whether to recommend that the rule be eliminated, modified, or permanently approved as is.

NASD Regulation also is amending IM-2110-5 to clarify that if it expires on August 31, 2003, Rule 2110(c)(3) also would expire at that time.

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ATTACHMENT A – RULE TEXT

New language is underlined; deletions are in brackets.

IM-2210-5. Requirements for the Use of Bond Mutual Fund Volatility Ratings

(This rule and Rule 2210(c)(3) will expire on August 31, [2001] 2003, unless extended or permanently approved by the Association at or before such date.)

(a) No change.

(b) No change.

(c) No change.