

NASD NOTICE TO MEMBERS 97-28

Approval Of Investment Company Rankings Amendments

Suggested Routing

- Senior Management
- Advertising
- Corporate Finance
- Government Securities
- Institutional
- Internal Audit
- Legal & Compliance
- Municipal
- Mutual Fund
- Operations
- Options
- Registration
- Research
- Supervisory Personnel
- Syndicate
- Systems
- Trading
- Training

Executive Summary

On March 5, 1997, the Securities and Exchange Commission (SEC) approved amendments to NASD[®] IM-2210-3 (Guidelines) to allow for the use by members and associated persons in advertisements and sales literature of investment company rankings that represent short-, medium-, and long-term performance. The amendments are effective March 5, 1997.

Discussion

In 1994, the SEC approved what is now IM-2210-3 of the NASD Rules, which provides guidelines for the use of rankings in investment company advertisements and sales literature.¹ Among other things, the Guidelines required that all advertisements and sales literature which include rankings to promote non-money market mutual fund performance, include rankings over one, and, if available, five- and ten-year periods. Before the Guidelines, there were no specific standards for the use of rankings, which generally had been selectively provided by members to show the best ranking over a given time period.

Since the approval of the Guidelines, NASD Regulation, Inc. (NASD RegulationSM) has considered whether to allow for greater flexibility in the use of time periods other than those prescribed by the Guidelines. The staff recognized that some ranking entities, because of the criteria and methodologies established and imposed by the entities, do not provide rankings based on the required time periods.

NASD Regulation has determined that performance rankings that use different time periods other than those prescribed by the Guidelines could help investment company investors make informed investment decisions if presented in a way that is not misleading. The Guidelines have

thus been revised to permit the use of different time periods consistent with the original goal to prevent performance selectivity of time periods. These changes have been approved by the SEC.

Description Of Amendments

The amendments revise subparagraphs (2)(B) and (C) to paragraph (d) of IM-2210-3 to provide that the Guidelines apply to rankings that use time periods reflecting short-, medium-, and long-term performance if rankings for the required time periods of one, five, and ten years are not published by the ranking entity. The amendments relax the requirement for standardized time periods but continue to provide that rankings be shown over multiple time periods, thus prohibiting members from portraying performance using just a “snapshot” view. The amendments provide a flexible framework within which member firms can provide ranking information to investors that is not in violation of the Guidelines.

The amendments also replace the phrase “in the category” in subparagraphs (2)(B) and (C) to paragraph (d) of IM-2210-3 with the phrase “relating to the same investment category” to clarify that when members include a total return ranking in advertisements and sales literature, the required rankings for multiple time periods must all be within the same investment category or subcategory as the total return ranking.

Finally, the amendments insert the phrase “other than rankings based on yield” after the word “rankings” in subparagraph (2)(A) to paragraph (d) of IM-2210-3. The language of subparagraph (2)(A) prohibits members from using rankings based on a period of less than one year in advertisements and sales literature. However, subparagraph (2)(C) to paragraph (d) of IM-2210-3 permits rankings based

on yield so long as the current SEC standardized yield is used. The SEC standardized yield requires yield quotations to be calculated on the basis of a 30-day period.² The amendments therefore remove any potential inconsistency between subparagraphs (2)(A) and (2)(C) to paragraph (d) of IM-2210-3.

Questions concerning this *Notice* may be directed to Thomas A. Pappas, Associate Director, Advertising Regulation, NASD Regulation, at (202) 728-8330; or Robert J. Smith, Senior Attorney, Office of General Counsel, NASD Regulation, at (202) 728-8176.

Text Of Amendments

(Note: New language is underlined; deletions are bracketed.)

CONDUCT RULES

2000. BUSINESS CONDUCT

2200. COMMUNICATIONS WITH CUSTOMERS AND THE PUBLIC

2210. Communications With the Public

IM-2210-3. Use of Rankings in Investment Companies Advertisements and Sales Literature

(a) through (c) No change.

(d) Time Periods

(1) Any investment company ranking set forth in an advertisement or sales literature must be, at a minimum, current to the most recent calendar quarter ended, in the case of advertising, prior to the submission for publication, or, in the case of sales literature, prior to use.

(2) Except for money market mutual funds:

(A) advertisements and sales literature must not use any rankings, other than rankings based on yield, based on a period of less than one year.

(B) any investment company ranking based on total return must be accompanied by rankings based on total return for [the] a one year period for investment companies in existence for one year; [the] one and five year periods for investment companies in existence for at least five years; and [the] one, five and ten year periods for investment companies in existence for at least ten years supplied by the same Ranking Entity [in the category], relating to the same investment category, and based on the same time period; provided that, if rankings for such one, five and ten year time periods are not published by the Ranking Entity, then rankings representing short, medium and long term performance must be provided in place of rankings for the required time periods.

(C) an investment company ranking based on yield may be based only on the current SEC standardized yield. An investment company ranking based on the current SEC standardized yield must be accompanied by rankings based on total return for [the] a one year period for investment companies in existence for one year; [the] one and five year periods for investment companies in existence for at least five years; and [the] one, five and ten year periods for investment companies in existence for at least ten years supplied by the same Ranking Entity [in the category], relating to the same investment category, and based on the same time period; provided that, if rankings for such, one, five and ten year time periods are not published by the Ranking Entity, then rankings representing short, medium and long term performance must be provided in place of rankings for the required time periods.

(e) through (f) No change.

Endnotes

¹ Securities Exchange Act Release No. 34-34354 (July 12, 1994); 59 FR 36461 (July 18, 1994).

² Rule 482 under the Securities Act of 1933, Advertising by an Investment Company as Satisfying Requirements of Section 10, 17CFR 230.482.

© 1997, National Association of Securities Dealers, Inc. (NASD). All rights reserved.