

NASD Notice to Members 98-107

NASD Reminds Members Of Their Obligations To Disclose Mutual Fund Fees

Suggested Routing

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Executive Summary

This *Notice* reminds National Association of Securities Dealers, Inc. (NASD®) members of their obligation to ensure that discussions concerning fees and expenses in mutual fund advertisements and sales literature as defined in NASD Rule 2210(a) are fair, balanced, and not misleading. This *Notice* also provides guidance concerning fee and expense disclosure in certain types of mutual fund sales material, and announces an NASD initiative to review this issue further.

Questions concerning this *Notice* may be directed to Thomas M. Selman, Vice President, Investment Companies/Corporate Financing, NASD Regulation, Inc. (NASD RegulationSM), at (240) 386-4533, or Robert J. Smith, Assistant General Counsel, NASD Regulation, at (202) 728-8176.

Requirements Concerning Disclosure Of Fees And Expenses

Lists Of Fees And Expenses That Do Not Apply

NASD Rule 2210(d)(1) generally requires that all member communications with the public provide a sound basis for evaluating the facts regarding a particular security or service and that they include material qualifications necessary to ensure that the communications are fair, balanced, and not misleading.¹ Rule 2210 also prohibits the use of exaggerated, unwarranted, or misleading statements or claims. NASD Regulation has long interpreted Rule 2210 to prohibit members from making misleading or confusing presentations in their sales material concerning the fees and expenses associated with a variety of investment products and services, including discount brokerage, wrap accounts, and variable products.

In particular, NASD Regulation strongly objects to presentations that list

specific fees that *do not* apply, without discussing the fees or expenses that *do* apply. Such presentations raise investor protection concerns because of the possibility that the presentations may confuse investors about the range of fees and expenses that the investors must pay when they purchase and own particular products.

NASD Regulation reminds members that all of their mutual fund sales material must similarly comply with NASD rules. Discussions of factors such as fees and expenses should be fair and balanced, whether the investment decision concerns the purchase of mutual funds or other investment products. In order to ensure greater consistency in the application of the principles concerning disclosure of fees and expenses, NASD Regulation now takes the interpretive position that if an item of sales material lists specific mutual fund fees and expenses that *do not* apply to the purchase, redemption, or ownership of the fund's shares, then this sales material ordinarily must list specific fees and expenses that *do* apply (*e.g.*, applicable maximum front-end and deferred sales charges and redemption fees, and operating expenses). As always, NASD Regulation staff will respond to questions from members who file such sales material, concerning the practical application of this interpretive position.

Disclosure Of Sales Loads Under SEC Rule 482

Members also are reminded that Securities and Exchange Commission (SEC) Rule 482 under the Securities Act of 1933 and SEC Rule 34b-1 under the Investment Company Act of 1940 require that sales material presenting data about the performance of an advertised mutual fund, also disclose the maximum amount of any sales load or other nonrecurring fee. In addition, SEC Rule 156 under the Securities Act of

1933, which provides guidance on when sales material may be misleading, indicates that statements about investment expenses may be relevant to whether an implicit representation about future performance has been made.

Use Of The Term “No-Load”

NASD Regulation does not currently interpret the SEC and NASD rules to require disclosure of total fund operating expenses or other applicable fees when sales material merely refers to the advertised mutual fund as “no-load” or part of a “no-load” family of funds. In addition, this type of disclosure is not currently required when, in discussing how to invest in the fund, the sales material states merely that the mutual fund imposes no sales charge.

Members are on notice, however, that NASD Regulation now takes the position that in all such cases, the sales material must disclose the fact that other fees and expenses do apply to a continued investment in the fund and are described in the fund's current prospectus. (This disclosure could accompany the disclosure telling investors to read the prospectus before investing.) Similar-

ly, sales material that discloses the load charged by a mutual fund also must disclose that other expenses apply to a continued investment in the fund and are described in the fund's current prospectus, to ensure that investors are not confused about whether the load represents the only fee or expense associated with the purchase or continued investment in the mutual fund.

Future Initiatives

NASD Regulation and its Investment Companies Committee (the Committee) recognize the importance of ensuring that presentations in member sales material concerning mutual fund fees and expenses are fair, balanced, and not misleading. Consequently, the Committee has recommended that the NASD Regulation staff comprehensively evaluate the standards applicable to the disclosure of fees and expenses in mutual fund sales material. The staff intends to consider, among other issues, whether:

- the existing NASD standards are adequate;
- certain types of sales material present specific concerns that should be

addressed through new NASD standards;

- NASD Regulation should impose specific requirements concerning the prominence of fee and expense disclosure in sales material; and
- other types of sales material should describe the fees and expenses that an investor could expect to incur when purchasing and holding an advertised mutual fund, including the fund's expense ratio, maximum sales charge, redemption fee, and maximum deferred sales load.

During its evaluation of these issues, NASD Regulation intends to seek the views of NASD members and the investing public.

Endnote

¹Rule 2210(d)(2)(E) specifically prohibits any statement that a service is furnished without any charge unless the service is furnished free without condition or obligation.

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