

# Notice to Members

SEPTEMBER 2006

## SUGGESTED ROUTING

Advertising  
Executive Representatives  
Investment Companies  
Legal & Compliance  
Mutual Funds  
Registered Representatives  
Senior Management

## KEY TOPICS

Mutual Fund Performance Advertising  
Fees and Expenses  
Rule 2210  
Rule 2211

## GUIDANCE

### Mutual Fund Performance Sales Material

SEC Approves Amendments to NASD Rules 2210 and 2211 to Require Disclosure of Fees and Expenses in Mutual Fund Performance Sales Material;

**Effective Date: April 1, 2007**

#### Executive Summary

On July 5, 2006, the Securities and Exchange Commission (SEC) approved amendments to NASD Rules 2210 and 2211 that impose certain disclosure and presentation requirements on member communications with the public, other than institutional sales material and public appearances, that present non-money market mutual fund performance data (performance sales material).<sup>1</sup> Such communications must disclose: (1) the standardized performance information mandated by Rule 482 under the Securities Act of 1933 (Rule 482) and Rule 34b-1 under the Investment Company Act of 1940 (Rule 34b-1); and (2) to the extent applicable, the fund's maximum front-end or back-end sales charge and annual operating expense ratio. The rule requires that all of this information be presented prominently and, in any print advertisement, in a prominent text box.

The effective date of this rule change is April 1, 2007. Included with this *Notice* is Attachment A (text of rule amendments).

#### Questions/Further Information

Questions or comments concerning this *Notice* may be directed to Joseph P. Savage, Associate Vice President, Investment Companies Regulation, Regulatory Policy and Oversight (RPO), at (240) 386-4534; or Philip A. Shaikun, Associate Vice President and Associate General Counsel, Office of General Counsel, RPO, at (202) 728-8451.

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Questions about individual performance sales material should be directed to the NASD Advertising Regulation Department analyst assigned to review the member's sales material.

## Background and Discussion

### Current Performance Advertising Standards

The content of mutual fund performance advertising is governed primarily by NASD Rules 2210 and 2211, Rule 482 under the Securities Act of 1933 and Rule 34b-1 under the Investment Company Act of 1940 (1940 Act). These rules help ensure that these communications are fair, balanced and not misleading.

Rule 2210 governs member communications with the public, including performance advertising. Rule 2210(d) provides that all member communications with the public must be based on principles of fair dealing and good faith, and should provide a sound basis for evaluating the facts in regard to any particular security or type of security, industry or service. The rule further provides that "no member may omit any material fact or qualification" if the omission would cause the communication to be misleading. Rule 2210(e) provides in part that any member violation of an SEC rule applicable to member communications will be deemed a violation of Rule 2210.

Rule 2211 sets forth separate standards for institutional sales material and correspondence. Rule 2211(d)(1) provides that 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.

Rule 482 and Rule 34b-1 permit the inclusion of performance information in investment company sales material. If performance information is included, Rule 482 requires disclosure of the fund's maximum sales charges and its average annual total return for the most recent one-, five- and 10-year periods, as of the most recent calendar quarter.<sup>2</sup> The total return must be calculated according to standards set by the SEC, taking into account sales charges and expenses.<sup>3</sup> These returns are generally referred to as standardized performance. These rules also require that the standardized performance figures be presented at least as prominently as any non-standardized performance information included in the sales material.<sup>4</sup> Rule 482 does not require a mutual fund performance advertisement to disclose the fund's expense ratio.

Prior to this rule change, NASD had not interpreted Rule 2210 or Rule 2211 to require performance advertising to include a fund's expense ratio. However, NASD believes that such information is just as important in evaluating whether to invest in a fund as the fund's maximum sales charge, since a fund's total annual operating expenses will impact its performance for as long as an investor holds shares in the fund.

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### **New Performance Advertising Standards**

On July 5, 2006, the SEC approved amendments to Rules 2210 and 2211 to impose certain disclosures and presentation requirements on performance sales material.<sup>5</sup> Specifically, Rule 2210(d)(3)(A) requires that such performance sales material disclose the standardized performance mandated by SEC Rule 482 and Rule 34b-1, and to the extent applicable, the maximum sales charge imposed on purchases or the maximum deferred sales charge, and the expense ratio, gross of any fee waivers or expense reimbursements. Both the sales charges and the expense ratio should reflect the amounts stated in the investment company's prospectus fee table, 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 if performance sales material appears in a print advertisement, the required information must be presented in a prominent text box.

These rule changes become effective on April 1, 2007. Accordingly, all member performance sales material that is used on or after April 1, 2007 must comply with the new requirements of Rule 2210(d)(3).

During the comment process for this rule, four principal issues arose. First, a number of commenters had questions about the rule's prominence requirements. Second, members inquired as to the application of the text box requirement to member advertisements. Third, commenters had questions concerning the expense ratio that must be disclosed in performance sales material. Fourth, questions have arisen regarding the use of previously filed performance sales material that is revised to meet the requirements of Rule 2210(d)(3) on or after April 1, 2007. We address and give guidance on each of these issues below.

#### ***Prominence Requirements***

Rule 2210(d)(3)(B) provides that all of the information required by paragraph (A) must be set forth "prominently." NASD will apply the same prominence and proximity standards for disclosure of the expense ratio as those used for standardized performance and sales charges under the SEC rules.

For example, the quotations of the standardized average annual total returns for one-, five- and 10-year periods must be set forth with equal prominence, and any quotations of non-standardized performance may not be set forth in greater prominence than the standardized performance.<sup>6</sup> Similarly, the disclosures of a fund's maximum sales load and expense ratio generally would have to be presented in print advertisements "in a type size at least as large as and of style different from, but at least as prominent as, that used in the major portion of the advertisement ..."<sup>7</sup> When fund performance data is presented on a Web site, members may present standardized performance through the use of a hyperlink, provided that the standardized performance is presented prominently and is consistent with the standards of SEC Rule 482.

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### ***Text Box Requirement***

Rule 2210(d)(3)(B) also provides that, in any print advertisement, the information required by paragraph (A) must be set forth in a prominent text box that contains only the required information and, at the member's option, comparative performance and fee data and other disclosures that are required to be in the advertisement under Rule 482 and Rule 34b-1. Thus, for example, a text box may include the prospectus disclosure language required by Rule 482, the performance of a relevant benchmark index, or a comparison of the fund's expense ratio to the average expense ratio of similar funds.

The text box requirement applies only to advertisements that appear in print advertisements, such as a print newspaper, magazine or other periodical. The text box requirement does not apply to printed sales literature, such as fund fact sheets, brochures or form letters, nor does it apply to Web sites, television or radio commercials, or any other electronic communication.

### ***Annual Fund Operating Expense Ratio***

Rule 2210(d)(3)(A)(ii)(b) requires performance sales material to disclose a fund's total annual operating expense ratio, *gross* of any fee waivers or expense reimbursements (the unsubsidized expense ratio), as stated in the fee table of the fund's prospectus. This requirement to disclose the unsubsidized expense ratio applies even if a fund's prospectus also discloses its expense ratio net of fee waivers or reimbursements (the subsidized expense ratio). NASD requires the disclosure of the unsubsidized expense ratio because fund advertisements, like prospectuses, are directed to prospective investors. The required expense ratio disclosure does not reflect fee waivers or reimbursements because they may not be available to fund shareholders in the future, and thus may mislead an investor without further explanation.

The rule does not preclude performance sales material from also presenting a fund's subsidized expense ratio, as long as the member presents both expense ratios in a fair and balanced manner in accordance with the standards of NASD Rule 2210. In this regard, NASD expects a member that also presents a subsidized expense ratio to disclose in the sales material whether the fee waivers or expense reimbursements were voluntary or mandated by contract, and the time period during which the fee waiver or expense reimbursement obligation, if any, remains in effect. In print advertisements, a member may show the subsidized expense ratio in the text box with the unsubsidized expense ratio as long as they are presented in a fair and balanced manner.

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### ***Use of Performance Sales Material on or after April 1, 2007***

Performance sales material used on or after April 1, 2007 will be required to meet the disclosure standards of Rule 2210(d)(3). At a minimum, members will be required to disclose the unsubsidized total annual fund operating expense ratio unless the sales material already discloses this ratio in a manner that meets the prominence requirements of Rule 2210(d)(3). Members will not be required to re-file with the Advertising Regulation Department (the Department) previously filed sales material if the only revision is the addition of the expense ratio.

All performance print advertisements also will be required to include a prominent text box and must be re-filed with the Department. The addition of the text box to previously filed advertisements alters the content and presentation of the performance information, requiring that the advertisement be re-filed with the Department.

Members that have questions about whether they must re-file previously filed performance sales material that has been revised to comply with Rule 2210(d)(3) should contact the Department staff.

### **Endnotes**

- 1 SEC Rel. No. 34-54103 (July 5, 2006), 71 Fed. Reg. 39379 (July 12, 2006) (File No. SR-NASD-2004-043).
- 2 SEC Rules 482(b)(3)(ii) and 482(d)(3).
- 3 SEC Rule 482(d)(3)(i).
- 4 SEC Rule 482(d)(5)(iv).
- 5 The rule does not apply to member sales material that includes only mutual fund rankings and does not include performance data, since sales material containing fund rankings is governed by IM-2210-3.
- 6 See SEC Rules 482(d)(3)(iii) and 482 (d)(5)(iv).
- 7 See SEC Rule 482(b)(5). Rule 482(b)(5) also provides that when performance data is presented in a print advertisement in a type size smaller than that of the major portion of the advertisement, the maximum sales load may appear in a type size no smaller than that of the performance data.

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## ATTACHMENT A

### Text of Rule Change

New text is underlined; deletions are in brackets.

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#### 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) the total annual fund operating expense ratio, gross of any fee waivers or expense reimbursements, as stated in the fee table of the investment company's prospectus described in paragraph (a).

(B) All of the information required by paragraph (A) must be set forth prominently, and in any print advertisement, in a prominent text box that contains only the required information and, at the member's option, comparative performance and fee data and disclosures required by Rule 482 and Rule 34b-1.

(e) No change.

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## 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 Rule 2210(d)(3).

(2) through (3) No change.