## RCA – April 1995 – Misuse Of Charts Comparing Index Returns Concerns NASD

Increased use of incomplete index performance charts in sales material on behalf of mutual funds and other investment products is of growing concern to the NASD Advertising Regulation Department. Many of these charts compare the performance of one index or average to another.

For example, a chart may compare the performance of the S&P 500 Index with the Russell 2000 Index or to historic returns on U.S. Treasury bills. These charts have the potential to mislead if an adequate explanation of the performance information is omitted. In other instances, sales material overemphasizes the index performance and either de-emphasizes or omits the actual returns of the offered security.

## **Explain Relevant Differences**

The NASD recognizes that comparisons may be helpful in making an investment decision. Article III. Section 35(d)(2)(M) of the Rules of Fair Practice specifically provides for use of comparisons in members' advertisements and sales literature. However, the rule requires that in order to provide a balanced comparison these charts should be accompanied by a clear explanation of the relevant differences between product types. Such differences may include liquidity, safety, guarantees, insurance, fluctuation of principal and/or return, and tax features. In addition, the purpose of the comparison must be clear.

For example, one of the most commonly used charts compares the historic performance of small company stocks, large company stocks, government bonds, Treasury bills, and CDs. In order to comply with the rule, such charts should be accompanied by the following types of disclosures:

- CDs are insured by the FDIC and offer a fixed rate of return, whereas the return and principal value of an investment in stocks fluctuates with changes in market conditions.
- The prices of small company stocks generally are more volatile than those of large company stocks.
- Government bonds and Treasury bills are guaranteed by the U.S. government and, if held to maturity, offer a fixed rate of return and fixed principal value.

In order to enhance a reader's under-standing of the material, the NASD requests that members include this important information in the main body of the presentation, and not in a foot-note or legend.

## **Disclosure Of Basis And Source**

The narrative accompanying the charts must identify the indexes, averages, or specific securities (such as three-month Treasury bills) on which the performance is based, and must disclose that past performance does not guarantee future results. Pursuant to Article III, Section 35(d)(l)(A), chart titles also should reflect the historic nature of the performance. The NASD further requires that the charted information be current. Text accompanying the charts must disclose the source of the performance information, as required under Article III, Section 35(d)(2)(K).

## **Index Performance Alone**

Member firms may include index performance to help the reader understand the long-term performance of a market sector. However, where a security has an existing performance record, materials could be misleading that overemphasize index performance without a fair discussion of

the security. Furthermore, index performance should not be the sole basis for selling a security. Rather, materials must provide a balanced discussion of a security's features, benefits, and risks. A security's current performance generally should be disclosed when index performance is included.

In certain instances, it may be acceptable to use index performance in a sales piece without the performance of the offered security, provided these conditions are met:

- The material includes language that clearly and prominently discloses that the index performance is not illustrative of the security's performance, and offers to provide the security's performance.
- The index performance is not presented in such a way to imply that an investment can be made in the index.

The sole use of index performance does not mask extremely poor performance by the offered security. If the security is without a track record, this should be disclosed, and the material should include the other relevant disclosures noted above.