

File No. SR-NASD-2004-043

Proposed amendments to Rule 2210 and Rule 2211 of the National Association of Securities Dealers relating to disclosure of mutual fund fees and expenses

Comments in reply to the Notice published by the Securities and Exchange Commission in the July 12, 2006 *Federal Register* (pp. 39379-39382)

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The objectives of the proposed rule changes are laudable, but the rule text is poorly drafted, resulting in ambiguity and possible misinterpretation; see comments 1-6 below. The NASD's Statement of Purpose—as recited in the July 12, 2006 Federal Register notice—also contains confusing statements; see comment 7 below.

1) It is unclear whether the proposed provisions apply to performance data for mutual funds that are not offered by the member issuing the communication

Broker-dealers sometimes disseminate communications that quote the performance of mutual funds which are not sold by the firm. This commonly occurs with reprints of articles originally published by an independent third party, such as a financial publication. For example, an article might discuss several funds, only one of which is offered by a broker-dealer that distributes a reprint of the article. The broker-dealer distributes the reprint for the purpose of promoting the sale of shares of the fund it offers, not the other funds mentioned in the article. Would the proposed rule provisions require the broker-dealer to add the standardized performance data and information about maximum sales charges for these other funds? On the face of the new rule language, the answer to this question appears to be “yes.” But such an interpretation would seem pointless with regard to the concerns which motivated the rule proposal. The Notice to Members to be issued by the NASD should address this point in order to clear up the ambiguity.

2) The “other than institutional sales material” language in proposed paragraph 2210 (d)(3)(A) is open to misinterpretation

We are not aware of anything issued by the SEC indicating that “institutional sales material,” as that term is defined by NASD Rule 2211, is exempted from the content standards of SEC Rules 482 and 34b-1. It is our understanding that any item of institutional sales material that quotes performance for a registered

open-end investment company must comply with the provisions of the SEC rules, including the requirements to show standardized performance data and the maximum sales charge. The inclusion of the phrase “other than institutional sales material” in proposed 2210(d)(3)(A) may lead some readers to the false conclusion that information specified in proposed paragraphs 2210(d)(3)(A)(i) and 2210(d)(3)(A)(ii)(a) (i.e., standardized performance and maximum sales charge) is not required in institutional sales material.

3) The “as permitted” language in proposed paragraph 2210 (d)(3)(A) is open to misinterpretation

When read literally, proposed paragraph (d)(3)(A) for Rule 2210 applies *only* to communications containing performance “as permitted” by SEC Rules 482 and 34b-1. In other words, this paragraph, taken on its face, does not apply to communications that contain only non-compliant performance data; i.e., performance data not permitted by the SEC rules. So...a communication containing only non-compliant performance data would not be required by proposed (d)(3)(A) to include standardized performance, and disclosure of maximum sales charges and gross expense ratios, because the proposed paragraph does not even apply to such a communication. Obviously, this is not what the NASD intended, but it is the way the proposed paragraph is written.

4) Proposed paragraphs 2210(d)(3)(A)(i) and 2210(d)(3)(A)(ii)(a) are unnecessary

These proposed paragraphs impose content standards that already are imposed by SEC Rules 482 and 34b-1. Further, existing paragraph (e) of NASD Rule 2210 already requires compliance with SEC rules, where they are applicable. Thus, the proposed paragraphs are completely redundant to the aforementioned regulatory provisions, add nothing new, and consequently are not needed.

5) It is unclear whether proposed 2210(d)(3) applies to annual and semiannual reports issued by registered mutual funds

Federal regulations require registered open-end investment companies to issue annual and semiannual reports to their shareholders. Broker-dealers disseminate these reports to their customers who are current or prospective investors in those funds offered by the broker-dealer. A broker-dealer must treat such a report as its own communication for the purposes of Rule 2210. For example, the NASD requires its members to file the Management Discussion of Fund Performance section of an annual report. Although mutual fund annual and semiannual reports now contain an expense example, as required by SEC Form N-1A, the expense ratio shown and used in the example is not the gross ratio shown the prospectus fee table. Nor does the expense example disclose sales charge schedules. So...would proposed 2210(d)(3) require a NASD member firm to add to such reports information about maximum sales charges and gross

expense ratios? The NASD should address this question in its forthcoming Notice to Members.

6) Proposed 2210(d)(3)(A) should be amended to make it clear that the new provisions apply to registered funds

It appears that the new rule provisions are intended to apply only to non-money market open-end investment companies that are registered with the SEC, and not unregistered funds. This point should be made clear by inserting the word “registered” into the rule text.

7) Explanatory remarks about prominence standards are contradictory

The NASD’s Statement of Purpose—as recited in the July 12, 2006 Federal Register notice—contains the following passage:

The information required by proposed NASD Rule 2210(d)(3)(A) (i.e., the standardized performance information, maximum sales charge, and total fund operating expenses) would have to be set forth prominently. NASD members could meet this prominence requirement by presenting this information in accordance with the prominence and proximity requirements of Rule 482 and Rule 34b-1. Additionally, members would be required to present a fund’s total annual operating expenses in a manner that meets the prominence and proximity requirements under Rule 482 for disclosure of a fund’s maximum sales charge.

The second sentence of this passage implies that conformance with the Rule 482 prominence and proximity standards is sufficient, but not necessary (“...*could* meet...”). But the final sentence appears to say that conformance with the Rule 482 standards is mandatory. This final sentence not only contradicts the preceding sentence, it also is not supported in the rule text itself, which contains no such mandatory requirement to match the Rule 482 standards.

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Here is alternative rule language that could address the deficiencies described above:

Rule 2210. Communications with the Public

(d) Content Standards

(3) Disclosure of Fees, Expenses and Standardized Performance

(A) Except as described in paragraph (B), paragraphs (i) and (ii) below apply to communications with the public that present performance data for a registered open-end management investment company.

(i) A print advertisement must set forth the following information 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 under the Securities Act of 1933 and Rule 34b-1 under the Investment Company Act of 1940:

- a. the standardized performance mandated by Rule 482 and Rule 34b-1;
- b. the maximum sales charge imposed on purchases or the maximum deferred sales charge, as stated in the investment company's current prospectus; and
- c. the total fund operating expenses, gross of any fee waivers or expense reimbursements, as stated in the fee table of the investment company's current prospectus.

(ii) A communication other than a print advertisement must prominently disclose the total fund operating expenses, gross of any fee waivers or expense reimbursements, as stated in the fee table of the investment company's current prospectus.

(iii) The term "current prospectus," as used in paragraphs (i) and (ii), means the 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.

(B) (i) The information specified in paragraphs (A)(i) and (A)(ii) is not required for a money market fund, or for a fund whose shares are not offered or sold by the member issuing or distributing the communication.

(ii) Paragraph (A)(ii) does not apply to institutional sales material, or to any annual report or semiannual report issued by an investment company.