



May 7, 2003

Jonathan G. Katz  
Secretary  
U.S. Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549

Re: SR-NASD-2003-13; Proposed Interpretive Material Regarding the Use of Investment Analysis Tools.

Dear Mr. Katz:

The Online Brokerage Legal and Technology & Regulation Committees (the “Committees”) of the Securities Industry Association (“SIA”)<sup>1</sup> appreciate the opportunity to comment on the above referenced rule filing of the National Association of Securities Dealers. SIA previously offered comments in response to an earlier Notice To Members from the NASD Board seeking comment from the public on the proposed Interpretive Material (“IM”).<sup>2</sup>

In that letter, SIA expressed support for the NASD’s effort to update its rules to accommodate new technology and for recognizing the potential value of investment analysis tools to the investing public. Nevertheless, SIA expressed concern that the NASD’s proposal placed unnecessary restrictions on technology that can be of enormous benefit to the investing public and which is already widely available to the public through unregulated channels. Moreover, SIA noted that applying the NASD’s prohibition on projections, originally intended to apply to marketed investments, to investment analysis tools had resulted in much confusion on the part of member firms because it appeared to

---

<sup>1</sup> The Securities Industry Association, established in 1972 through the merger of the Association of Stock Exchange Firms and the Investment Banker's Association, brings together the shared interests of more than 600 securities firms to accomplish common goals. SIA member-firms (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. According to the Bureau of Labor Statistics, the U.S. securities industry employs more than 700,000 individuals. Industry personnel manage the accounts of nearly 93-million investors directly and indirectly through corporate, thrift, and pension plans. In 2002, the industry generated \$214 billion in U.S. revenue and \$285 billion in global revenues. (More information about SIA is available on its home page: [www.sia.com](http://www.sia.com) .)

<sup>2</sup> Available at [http://www.sia.com/2002\\_comment\\_letters/pdf/ntm02-51.pdf](http://www.sia.com/2002_comment_letters/pdf/ntm02-51.pdf).

contradict other statements, interpretations and rule language permitting such tools. Finally, SIA noted that the broadened application of the prohibition has the effect of making the well-intended exception seem exceptionally narrow, unnecessarily burdensome to comply with, and of marginal value.

The revised IM language is a slight improvement over the earlier version in the NASD Notice to Members. For example, the NASD has helped to clarify the definition of tools that the IM covers. Nevertheless, the IM does not resolve the uncertainty over which regulatory regime applies to investment analysis tools - the rule prohibiting predictions and projections, the existing exception to this rule for hypothetical illustrations of mathematical principles, the exception to this rule for tools as proposed in the IM, or the rule permitting forecasts that are not unwarranted and have a reasonable basis.

Many members have been relying on the language of Rule 2210(d)(2)(C) that allows forecasts in making planning tools available to their clients, provided that forecasts are not unwarranted and have a reasonable basis. In addition, NASD Rule 2220 (options advertising) and NYSE Rule 472 (Advertising) permit predictions, projections, and forecasts that are not unwarranted and are clearly labeled as such. Most recently, the NASD issued IM-2210-7 relating to Guidelines for Communications With the Public Regarding Security Futures. The IM specifically allows projected performance figures (including projected annualized rates of return) in security future sales literature and correspondence provided that certain conditions, mostly addressing required disclosures, are met.

Rule 2210(d)(2)(N), prohibiting predictions and projections, has traditionally been applied to claims of projected returns on a particular investment that is being advertised or otherwise marketed to customers. Indeed, the first appearance of this prohibition occurred in 1982 in the NASD's Mutual Fund Guidelines, and it was intended to deal with promises of returns in advertising material for investment company securities and variable annuity contracts.<sup>3</sup> Members were thus surprised and troubled by the statement in the IM that "the NASD has interpreted this rule as prohibiting members from providing customers access to investment analysis tools that show the probability that investing in specific securities or mutual funds will produce a desired result." Of course, SIA believes that such a prohibition is clearly appropriate to address communications to customers that promise or imply investment returns in the context of advertising or marketing a particular investment. However, we would strongly disagree with the notion that investment analysis tools, made available to customers with appropriate disclosures, produce the kind of potentially misleading marketing information that such regulations

---

<sup>3</sup> See NASD Notice to Members 81-9 (March 10, 1981) (proposing the Guidelines for member comment); NASD notice to Members 82-5 (Feb. 8, 1982) (adopting the guidelines).

were designed to prevent. It is also worth noting that this prohibition includes an exception for “hypothetical illustrations of mathematical principles, including illustrations designed to show the effects of dollar cost averaging, tax-free compounding, or the mechanics of variable annuity contracts or variable life policies.” Many members view their tools as also falling under this exception because they are based on well-known mathematical models.

Tools that help clients allocate assets, analyze portfolios and plan future investments are of vital importance to customers and are typically not used to market investments to customers. Tools of this kind have been available to institutional investors for some time, but advances in technology have brought them within the reach of retail investors. These tools generally are offered as a starting point for an investor’s research or planning. The tools provide value by enabling investors to evaluate different scenarios, such as portfolio performance, by manipulating the data they enter. For example, bond calculators assist customers in analyzing the potential performance of certain types of fixed income securities under certain interest rate scenarios, and sophisticated risk management tools allow customers to analyze (“stress test”) expected portfolio performance under specific scenarios. The interactive nature of these tools also suggests that output will largely depend on whatever information is input by the client. SIA believes these factors clearly distinguish the output of investment analysis tools from the kinds of misleading promotions that the rule was originally designed to curb.

The practical result of interpreting such tools as falling under the existing prohibition of Rule 2210(d)(2)(N) is that they can only be used by following the steps outlined in the IM. SIA member firms are concerned that these requirements, which mandate specific disclosures and additional information that must be a part of the tool’s presentation, will limit the use of the tool by firms and confuse customers. For example, the requirement that the tool present “a range of probabilities that various outcomes might occur” is problematic for in the case of a tool whose output is designed to show a specific probability based on user-defined assumptions (i.e., when a user requests the tool to show the user’s chance of achieving a specific dollar income at retirement based on the user’s existing portfolio). Although the specific disclosures currently mandated might not be appropriate in all situations, a requirement to provide disclosures that describe the inherent limitations of the tool might be more practicable.

Another result of treating investment analysis tools as analogous to advertising under the proposed IM is that the IM will require members to file tools with the NASD’s Advertising Regulation Department prior to use. SIA members oppose this requirement as unwarranted in the case of investment analysis tools. There is no rational basis to treat these tools as inherently suspect communications. First, there is no record of deception associated with the use of such tools to warrant such treatment. Second, such tools are already commonly available through unregulated financial portals, which would put

brokers at a competitive disadvantage in providing such analysis to their customers. Third, NASD Advertising Department staff frankly admits that it does not have the expertise needed to evaluate the sophisticated mathematical processes and algorithms that are the basis of these tools, and it will be reviewing only for the presence of appropriate disclosure language. Tools developed by third parties for a broker-dealer may be subject to contractual confidentiality clauses designed to protect the intellectual property of the developer. Any changes that may be suggested by the NASD staff could require additional expensive development costs and lead to further delays, or cause a broker-dealer licensee of a tool to cancel plans to offer the tool in the event a licensor is unable or unwilling to alter its proprietary product.

## RECOMMENDATIONS

Given the existing rules discussed above that permit forecasts, and the existing exception for hypothetical illustrations included in the rule itself, the NASD needs to more precisely define in the final IM the scope of the Rule 2210(d)(2)(N) prohibition as applied to investment analysis tools, and the new exception. Listed below are our recommendations for clarifications to the IM.

- First, a tool that an investor interacts with that projects probabilities of performance of specific recommended securities or funds should be permitted, as generally proposed by the IM, but with more flexible provisions for disclosure, presentation of information, and documentation of the general mathematical process used.<sup>4</sup> Such tools should not be treated as advertising material and made subject to the burdensome pre-filing and review requirements. That requirement should be removed in the case of these tools.
- Second, tools that may include yield or performance information as part of an analysis of a client's portfolio in light of client-supplied goals, tools used internally by a registered representative or investment adviser in the course of preparing advice to clients, and tools provided to institutional customers (as defined in Rule 3110(c)(4)) should be clearly excluded.
- Third, the language in the IM suggesting a broader historical interpretation of the scope of Rule 2210(d)(2)(N) prohibition as applied to tools should be revised to avoid upsetting settled expectations. Given the existing rules described earlier that presently permit forecasts, and the exceptions from

---

<sup>4</sup> Of course, to the degree a tool recommends a client invest in specific securities or funds, the NASD's suitability rule would apply. See NASD Rule 2310 and NASD Notice to Members 01-23 (Policy Statement Re: Online Suitability).

this rule for performance figures and hypothetical illustrations of mathematical principles, it may be more accurate to describe the NASD's prior application of the prohibition as applying to communications (generated by a tool or otherwise) that unfairly implied a specific result, included exaggerated or unwarranted claims or contained misrepresentations.

SIA appreciates the opportunity to provide comments and strongly recommends that the staff take the opportunity to become familiar with these tools before passing judgment on the NASD's filing. SIA would welcome the opportunity to arrange for the staff a demonstration or demonstrations of the kinds of tools in use at broker-dealer firms. If you would like to arrange such a meeting or if you have any questions about this letter, please contact Scott Kursman, Vice President & Associate General Counsel, at 212-618-0508; [skursman@sia.com](mailto:skursman@sia.com).

Very truly yours,

---

Eliot Wagner  
Chair, Technology &  
Regulation Committee

---

Hardy Callcott  
Chair, Online Brokerage  
Legal Committee

Cc: Hon. William H. Donaldson, Chairman, SEC  
Hon. Paul S. Atkins, Commissioner, SEC  
Hon. Roel C. Campos, Commissioner, SEC  
Hon. Cynthia A. Glassman, Commissioner, SEC  
Hon. Harvey J. Goldschmid, Commissioner, SEC  
Annette L. Nazareth, Director, Division of Market Regulation  
Kathy England, Assistant Director, Division of Market Regulation  
Joseph Morra, Division of Market Regulation  
Paul F. Roye, Director, Division of Investment Management  
Nancy C. Libin, Assistant General Counsel, NASD  
James S. Wrona, Assistant General Counsel, NASD