



SR NASD 200313-1

April 24, 2003

Mr. Jonathan G. Katz  
Secretary  
U.S. Securities and Exchange Commission  
450 Fifth Street, NW  
Washington, DC 20549-0609

**RE:** NASD Proposed Interpretive Material Regarding the Use of  
Investment Analysis Tools; File No. **SR-NASD-2003-13**

Dear Mr. Katz:

Fidelity Investments<sup>1</sup> appreciates the opportunity to comment on a proposal by the National Association of Securities Dealers ("NASD") to adopt a new Interpretive Material ("IM") regarding the use of investment analysis tools by NASD member firms.<sup>2</sup> Fidelity generally supports the proposed IM, which is very narrowly tailored to address one type of investment tool—those that are designed to show the probability of achieving a desired outcome based on specific securities or fund investments. Although it is important for investors to benefit from access to these types of tools, we believe that the IM should not change the ability of firms to currently develop and use other types of investment tools.

Fidelity is a leader in providing self-directed retail investors with many different types of on- and off-line investment tools. We design and offer these tools as a result of extensive investment and technological research and development. Our tools, ranging from basic retirement calculators to sophisticated investment planning programs, typically do not predict or project the outcome of specific securities, rather they are designed to be hypothetical and general in nature. They are intended to help investors understand how to plan for retirement, college and other financial goals.

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<sup>1</sup> Fidelity Investments comprises a group of diversified financial services companies, including a leading online brokerage firm, several other registered broker-dealers, as well as the largest mutual fund complex in the United States.

<sup>2</sup> Release No, 34-47590 (Mar. 28, 2003), 68 *Fed. Reg.* 16325 (April 3, 2003) [hereinafter *Release*].

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At the outset, Fidelity is alarmed that the Securities and Exchange Commission ("Commission") provided only limited notice of the publication of the revised IM. We were unable to find notice of the revised IM on [www.sec.gov](http://www.sec.gov) or in the *SEC Digest*. Given the significance of this proposal to NASD member firms, it is surprising that the Commission only used publication in the *Federal Register* as its form of notice, when it typically provides notice on its web site for many other rules. In addition, we believe that the 21-day comment period is too short for industry groups and the public to develop comments appropriately. We are unaware of a pressing requirement or need to adopt the rule proposal within such a short period of time. Accordingly, we strongly recommend that the Commission provide public notice through its web site and a longer public comment period for any future significant self-regulatory rule proposals.

Our comments on the proposed IM ask the Commission to: (1) revise the definition of investment analysis tool to clarify that it applies only to probability tools that include specific securities or funds in the analysis and to allow for the use of a single probability score; (2) eliminate the ambiguous requirement that tools be "audited"; (3) permit firms to rationalize the required disclosure on written reports and sales literature; and (4) eliminate the 30-day pre-filing and approval requirement. These comments are discussed below.

I. Definition of "Investment Analysis Tool"

a) Clarifying the Application to Specific Securities and Funds

Fidelity is pleased that the Commission's Release specifically clarifies how the IM fits under Rule 2210(d)(2)(N), which generally prohibits NASD member firms from making predictions or projections of specific investment results to the public. The proposed IM would permit member firms to provide their customers with "investment analysis tools that show the probability that investing in specific securities or mutual funds will produce a desired result."<sup>3</sup> Under the proposal, these tools could be used with the public as long as certain design, disclosure and filing requirements are met.

Presently the NASD has interpreted Rule 2210(d)(2)(N) as prohibiting the use of these types of tools with the public.

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<sup>3</sup> *Id.*, at IM note 1.

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In Fidelity's comments on the NASD's initial proposal, we recommended, among other things, that the NASD clarify the scope of the rule proposal.<sup>4</sup> It was our concern that if the rule proposal was designed to apply to a broad array of investment tools it might upset the longstanding use of various educational investment tools by firms, which historically has not been prohibited by the NASD under Rule 2210(d)(2)(N). We recommended that the NASD either narrow its rule proposal to a specific type of investment tool as discussed below or re-draft the rule proposal.

As the IM appropriately notes, neither Rule 2210(d)(2)(N) nor the IM would prohibit the use by member firms of "automated educational tools that are hypothetical or general in nature . . . [for example] portfolio-based planning tools that merely generate a suggested mix of asset classes, broad categories of securities or funds, or probabilities as to how classes of financial assets or styles of investing might perform."<sup>5</sup> It is our understanding that member firms have used these types of tools with the public for years and that the NASD staff has been aware of, and in some cases reviewed and approved of, these tools.

We are concerned, however, that the IM's actual definition of "investment analysis tool" does not clearly reflect this distinction between tools that show a probability that investing in specific securities or mutual funds will produce a desired result and tools that show probabilities as to how classes of financial assets or style of investing might perform. Although this distinction is indicated in the IM's first footnote, we strongly recommend that the definition be revised to address this concern (as indicated below).

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<sup>4</sup> See Letter from Alexander C. Gavis, Fidelity Investments, to Barbara Z. Sweeney, NASD, (dated, Oct. 1, 2002).

<sup>5</sup> 68 *Fed. Reg.* at p. 16325.

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### **b) Presenting a Single Probability Score**

In Fidelity's comments on the NASD's initial proposal, we also recommended that the definition be revised to also include tools that present a single probability of achieving a desired result, rather than limiting the definition to tools that provide a range of Probabilities. We continue to advocate that a single probability score or number can be presented in a fair and balanced manner with the use of disclosure and/or tool functionality.

For example, a tool that delivers a single probability that an investor will achieve a desired goal, say saving \$500,000 in 20 years, could also provide that investor the opportunity to solve for other probabilities given different goals amounts. This, in effect, provides a similar result, without the tool providing a "range of probabilities." Also, limiting the definition to tools that provide only a range of probabilities may require member firms to incur additional development costs to modify existing probability tools that otherwise satisfy this IM, but fail to provide a range of probabilities. Finally, the requirement that these tools prominently provide a fair and balanced representation of the range of possible outcomes (*i.e.*, upside, downside and median projections) further acts to prevent the presentation of a single probability score from being considered misleading.

Accordingly, based on the above-mentioned comments, we recommend revising the definition of "investment tool" to including the following language (additions indicated in *italics*):

#### **(b) Definition**

For purposes of this Interpretive Material and any interpretation thereof, an "investment analysis tool" is an interactive technological tool that produces simulations and statistical analyses that present a *probability or range of probabilities that investing in specific securities or mutual funds will produce a desired result, various outcomes might occur*, thereby serving as an additional resource to investors in the evaluation of the potential risks of and returns on particular investments.

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## II. Disclosure Requirements

The proposed provisions under IM-2210-(c) require member firms to adhere to particular disclosure and substantive requirements. Fidelity believes several of these requirements should be revised; and specifically, we suggest the following changes.

### a) IM-2210-(c)(3): Requirement that the tool use a mathematical process that can be audited and reviewed.

One of the requirements for an "investment analysis tool" is that the "tool use[] a mathematical process that can be audited and reviewed."<sup>6</sup> Fidelity believes that this language is ambiguous and should be clarified.

We believe that the intent of the language is to provide the NASD with the ability to review and audit a member firm's investment tool. If this reading is accurate, the word audit appears to be redundant, since it is presumed that, as part of the review of the tool, the NASD staff will assess whether the tool works appropriately. We recommend deleting the words "audited and" from the IM text.

We do not believe that the word audit should be interpreted by the NASD staff to mean that member firms must obtain a third-party audit of an investment tool in order to comply with the rule. This requirement would result in increased costs, without benefiting investors, and would primarily benefit accounting firms. Member firms would have to spend significant time educating accounting firms of the mechanics of the tool and justifying the results. We strongly believe that any auditing of the tool should be left to the discretion of the member firm.

### b) IM-2210-(c)(6): Requirement to "disclose the universe of investments considered."

Under this section, member firms would be required to disclose the universe of investments considered in the analysis and state that other investments not considered may have characteristics similar or superior to those being analyzed.

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<sup>6</sup> *Id.* at p. 16326.

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Fidelity believes that this section should be revised to require the member firm only to describe the universe of investments considered in the analysis. For example, such a universe could be described as "all investments currently held by the investor," "all investments available through the member," or "those investments that are available for purchase in the accounts being analyzed by the tool."

Investors would likely be confused by boilerplate disclosure stating that other similar investments were not considered. This is especially acute in the area of retirement investing. For example, telling a retirement plan participant that a tool only considered investments which are available for purchase in the retirement account is logical; stating that other similar investments were not considered could be potentially confusing since these other investments would not be available for purchase because of retirement plan limitations. For general retail customers, this would give them the impression that the "grass may be greener" with other investments, but would fail to provide the investor with any meaningful analysis.

### **III. Disclosure Requirements for "Written Reports" and "Sales Material"**

The proposed disclosure requirements set forth in the IM would apply to the investment analysis tool *and* (1) to any "written reports indicating the results generated by [the tool]" and (2) "any related sales material." Fidelity has two concerns with disclosure requirements for written reports and sales material.

The current proposal has added written reports to be covered by the disclosure requirements. We believe that, rather than simply requiring that all written reports contain the same disclosure as the tool, the IM should allow firms discretion to determine the best approach to apply disclosure between the tool and the reports. Otherwise, the reports may contain virtually the same disclosures as the tool itself, which may be unhelpful and redundant for investors. In our opinion, it would make more sense to require firms to rationalize disclosure between the report and the tool so that investors can obtain a clearer and simpler expression of the required disclosure, potentially resulting in a higher likelihood of their reading the actual disclosure information.

Second, Fidelity believes that **the** disclosure requirements should not be applied broadly to all tool-related sales material. The disclosure requirements should only apply to sales material that contains either a detailed description of the tool or investor-

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specific probability presentations. Otherwise, all pieces of sales material could be required to comply with the substantive and disclosures requirements outlined in IM-2210-(c) and IM-2210-(d). Since these disclosures are designed to accompany the presentation of probabilities that various investment outcomes might occur, they would be out of context if the sales material references did not include specific mention of probabilities based on investor input.<sup>7</sup>

Accordingly, for both written reports and sales material, Fidelity believes that the NASD should not apply a blanket disclosure rule. Member firms should have the flexibility to determine appropriate disclosure for a given report or piece of sales material.

#### **IV. The 30-day Pre-filing and Approval Requirement**

The proposed IM would require member firms to provide to the NASD staff, at least 30 days prior to use, (1) access to the investment analysis tool, and (2) a filing of any templates for written reports produced by, or sales material concerning, the tool. The member firm would not be able to use the tool or related reports or sales material with the public until the staff has approved of it.

Fidelity strongly opposes the 30-day access and pre-filing requirement, since we believe that it would result in significant delays in the launch of investment tools to investors. The development times for investment analysis tools can be quite substantial. The time period from concept to deployment of a tool depends on its level of complexity and can vary from a few months to over a year. For a complex investment tool, a member firm might design a user interface, develop the software code to run the tool, stress test the tool internally and with focus groups, develop reports and then train registered representatives who will support the tool.

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<sup>7</sup> We recognize that the IM currently states that “[s]ales material that contains only an incidental reference to an investment analysis tool (e.g., a brochure that merely mentions a member’s tool as one of the services offered by the member) does not need to include the disclosures required [in the] Interpretive Material and does not need to be filed with the Department. . . .” *Id.* at p.16325. However, we believe that the standard should be broader than mere mention of the tool in sales literature. Members should be provided with discretion to use disclosure if indeed the context would warrant it (e.g., where there is a detailed discussion of the tool or an investor-specific probability analysis).

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By requiring that investment analysis tools and sales material covered by the IM be pre-approved, the NASD is, in effect, inserting itself into the development cycle of these tools. If, as discussed above, the NASD were to review and audit each tool, it would be likely that the staff would need to obtain access to the tool that is in the near final stages of development. This would allow them to observe how the disclosures will be displayed, to test the functionality, and to run various scenarios to audit results. We believe that the access and pre-filing requirements will result in member firms devoting a significant amount of time to negotiating comments with the NASD at the last stages of development, detracting from focus on launching the tool with the public. In addition, at that phase in the development cycle – when the product is in final testing – it may be very costly and confusing to make changes to the software code.

The proposed IM also states that the NASD approval requirement is not a “merit based” review, and that the NASD staff will review the tool merely to confirm that disclosures in the IM and in other NASD rules are made. Given this assumption, then we believe that there is no need for prior filing, review and approval. The NASD staff could conduct its review in due course or after a member has first used the tool.

We believe that the proposed review would be an inefficient extension of the NASD staff’s responsibilities, particularly when the staff is not charged with responsibility of pre-screening other types of investment tools.<sup>8</sup> Although member firms may wish voluntarily to pre-file tools with the NASD, we do not believe that it should be a mandatory requirement. Instead, the NASD should focus on examining and evaluating tools after they have been completed and presented to the public. We recommend that the NASD eliminate the pre-filing requirements in order to allow member firms more practically to focus on bringing investment tools to the market.<sup>9</sup>

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<sup>8</sup> In general, only investment analysis tools that concern registered investment companies are subject to filing and review requirements. Most other investment tools sponsored by member firms are not subject to filing, let alone pre-filing requirements.

<sup>9</sup> We also recommend that the Rule 2210 filing, approval and record keeping requirements not apply to amendments to a tool, written report or sales material that are solely updates to pre-existing content that has already been approved by the NASD. This approach is consistent with the NASD’s handling of statistical updates to member firm’s websites.



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Fidelity appreciates the opportunity to comment on this important proposal. Please contact me either by telephone at 617.563.6308 or by e-mail at [alexander.c.Eavis@fmr.com](mailto:alexander.c.Eavis@fmr.com) should you have questions concerning our views.

Sincerely yours,

A handwritten signature in black ink that reads "Alexander C. Eavis". The signature is written in a cursive, flowing style.

Alexander C. Eavis  
Associate General Counsel

cc: Paul F. Roye, Director, Division of Investment Management  
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