

ICI Comments on NASD Fund Advertisement Review Proposal, May 2005

May 20, 2005

Barbara Z. Sweeney
Office of Corporate Secretary
NASD
1735 K Street, NW
Washington, DC 20006-1500

Re: NASD Request for Comment on Proposal to Require Pre-Use Filing of Sales Material for New Types of Securities and Television, Video, and Radio Advertisements (NASD Notice to Members 05-25)

Dear Ms. Sweeney:

The Investment Company Institute ¹ appreciates the opportunity to comment on NASD's proposed rule changes to require pre-use filing of sales material for new types of securities, and television, video, and radio advertisements. ² The Institute has supported ? and continues to support ? NASD review of fund advertisements. We are concerned, however, that the breadth of the proposal will lead to significant delays in the dissemination of fund advertisements without providing corresponding benefit to fund investors. For this reason, we recommend that NASD modify the proposal to target those advertisements that may warrant pre-use review. For example, we recommend that NASD require pre-use filing of fund advertisements with performance information. By so refining the scope of its review, NASD will effectively utilize scarce staff resources while assuring that it addresses potential investor protection concerns.

Our specific comments are discussed below.

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Pre-Use Filing of Television, Video, and Radio Advertisements

Television and Radio Advertisements

NASD's proposal requires television and radio advertisements of 15 seconds or longer to be filed with NASD at least 10 business days prior to use and prohibits these advertisements from being used until changes specified by NASD's advertising department have been made. The Notice explains that NASD is concerned that, in the past, some members used broadcast advertisements that raised regulatory issues, and a pre-use filing requirement would permit NASD to resolve regulatory concerns before advertisements reach numerous retail investors.

The Institute does not object to pre-use filing of certain mutual fund television and radio advertisements. We are concerned, however, that applying a pre-use filing requirement to all television and radio advertisements and prohibiting use of these advertisements "until any changes specified by the Department have been made" will result in significant and unnecessary delays in members' use of advertising material without providing concomitant benefits to investors.

Mutual fund advertisements, including television and radio advertisements, currently must be filed with NASD within 10 business days of first use. Our members have advised us that they typically do not receive comments from the NASD staff for approximately 8 to 12 weeks after filing. Members have further advised us that, often when they have attempted to expedite this process, the NASD staff has denied their requests for expedited review due to backlogs. Requiring the more than 5,000 NASD members to begin pre-filing all television, radio, and video advertisements will undoubtedly exacerbate the current backlogs and result in even greater delays. Moreover, not permitting publication until "any changes specified by the Department have been made" will involve more than a single set of comments, thus further lengthening overall review time.³

Denying a fund's ability to utilize an advertisement for possibly as long as several months after filing seems unreasonable.⁴ Permitting funds to file storyboards for review will not resolve these concerns. Even if storyboards are permitted, developing a production schedule that must allow for an unpredictable and possibly lengthy amount of regulatory review time will be unworkable. For example, talent and production schedules must be established months in advance.⁵ Moreover, it is unfair to deny the timely use of all mutual fund television and radio advertisements based on regulatory delays

wholly outside of a fund's control. At the same time, we recognize NASD's desire to review and resolve any possible regulatory concerns with fund advertisements.

To balance these competing interests, we recommend that NASD modify the proposal in two respects. First, we recommend that NASD narrow the scope of the proposed pre-filing requirements to exclude any radio or television advertisement that does not contain performance information. Limiting the pre-use filing requirement to television and radio advertisements with performance information will effectively focus NASD resources on advertisements that may warrant pre-use review. There is precedent for distinguishing performance advertisements from advertisements that do not contain performance information. In fact, regulatory steps recently taken by both NASD and the Securities and Exchange Commission impose less stringent requirements on fund advertisements that do not contain performance.⁶ We believe such a distinction also is appropriate here.

At a minimum, NASD should exclude generic television and radio advertisements from pre-use filing requirements. The contents of generic advertisements are strictly limited under Rule 135a under the Securities Act of 1933. Such advertisements are most often used to educate investors about investing concepts, such as dollar cost averaging. They are not even permitted to promote sales of a particular fund. Because of these limitations, we do not believe generic advertisements should be subject to the proposed pre-filing requirement.

In addition to narrowing the scope of the pre-use filing requirement, we recommend that NASD revise the proposal to provide that any television or radio advertisement required to be pre-filed may be used within a reasonable period of time (e.g., 10 business days) from filing. This change will address concerns about undue delays if advertisements cannot be used until any changes specified by NASD have been made. We note that there is precedent for this type of review process, and we do not believe it has been problematic.⁷

In considering our recommended modifications to the pre-use filing requirement, we urge NASD to take into account that all such advertisements will continue to be subject to stringent safeguards, including principal review and approval,⁸ post-use review, and spot checks and oversight by both NASD and the SEC during examinations. This internal review and regulatory oversight will provide ample protection to investors. Importantly, our proposed approach will achieve NASD's policy goal while placing less of a burden on NASD's already strained resources.

Video Advertisements

Video advertisements also should be excluded from a pre-use filing requirement. They are particularly time sensitive and requiring their approval by NASD prior to use would create an unnecessary regulatory burden.⁹ For example, a portfolio manager may record an interview for broadcast on a fund's Web site in response to a particular market event. Delaying that video (even for a 10-day review period) would greatly reduce or eliminate the timeliness and relevance of the portfolio manager's comments. In addition, we do not believe it is necessary or appropriate to subject videos on a fund's

Web site to a more stringent filing requirement than other material on a fund's Web site. The Notice does not provide a rationale for the proposed distinction, and we are not aware of any particular regulatory concerns with fund videos. Consequently, we recommend that all parts of a fund's Web site, including any videos, continue to be required to be filed within 10 days of first use.

In addition to using videos on their Web sites, funds typically use videos in investor centers and in presentations to retirement plan sponsors and retirement plan participants. These video advertisements are not publicly broadcast like television and radio advertisements and consequently they reach a much more limited audience of investors that affirmatively elect to view the video. These types of videos will be seen in the context of a broader presentation where, in many instances, a fund representative will be present to answer any questions. Accordingly, there should be less reason for regulatory concern, and they should be permitted to be filed within 10 days of first use.¹⁰ Video advertisements, like other fund advertisements, will continue to be subject to the other significant protections discussed above.

Compliance with New Requirements

Requiring pre-filing of radio, television, and video advertisements for the first time will require NASD members to change their policies and processes associated with the production, internal review and approval, filing, distribution, and use of such materials. While the precise impact will vary depending on the nature of the final requirements, we recommend that NASD provide a compliance period of at least six months.

Sales Material Concerning New Types of Securities

NASD also proposes to require pre-use filing of sales material for new types of securities. The Notice indicates that this requirement will not apply to sales material that is already subject to a filing requirement, such as mutual fund sales material. We agree with NASD's decision not to require NASD members to pre-file advertisements and sales literature each time they bring a new mutual fund to market. For example, we do not believe that it is necessary to require a member firm that offers money market funds to pre-file advertisements and sales literature for a newly offered money market fund (or any other type of fund). These advertisements already are required to be filed within 10 days of first use, and we do not believe pre-filing is necessary.

NASD's proposal requires pre-use filing of advertisements and sales literature for a "type of security that the member has not previously offered." The Notice requests comment on whether the pre-use filing requirement should apply to advertisements and sales literature for products that the member has previously offered but now is offering to "a new class of investors" for the first time. We do not believe that it is necessary to require pre-filing of mutual fund sales material based on a change in the class of investor to whom the fund offers its shares if pre-filing would not otherwise be required. The requirement that all mutual fund advertisements and sales literature must be filed within 10 business

days of first use seems sufficient to address any concerns that NASD might have.

* * *

We appreciate the opportunity to comment on NASD's proposal. We recognize NASD's desire to review and resolve any possible regulatory concerns with television, radio and video advertisements prior to their dissemination. At the same time, denying a fund's ability to use all television, radio and video advertisement for possibly as long as several months after filing is unreasonable. To balance these competing interests, we urge NASD to follow our recommended approach. If you have any questions about our comments or need additional information, please contact me at 202/218-3563.

Sincerely,

Dorothy M. Donohue
Associate Counsel

cc: Thomas M. Selman, Senior Vice President, Investment Companies/Corporate Financing
Thomas Pappas, Associate Vice President and Director, Advertising Regulation
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Susan Nash, Associate Director
Douglas Scheidt, Associate Director and Chief Counsel
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ENDNOTES

¹ The Investment Company Institute is the national association of the U.S. investment company industry. ICI members include 8,512 open-end investment companies (mutual funds), 650 closed-end investment companies, 143 exchange-traded funds and 5 sponsors of unit investment trusts. Mutual fund members of the ICI have total assets of approximately \$7.959 trillion (representing more than 95 percent of all assets of US mutual funds); these funds serve approximately 87.7 million shareholders in more than 51.2 million households.

² See NASD Notice to Members 05-25 (April 2005) ("Notice").

³ Our members report that it takes longer for NASD to complete its review of fund advertisements with bond volatility ratings and self-created rankings, both of which must be withheld from publication until any changes specified by the Department have been made. See Rule 2210(c)(4). In contrast, advertisements subject to post-use filing typically are subject to a single set of comments.

⁴ We are concerned with NASD proposing to require pre-filing of the scripted portion of a radio or television show for the same reasons. In addition, it would be unworkable to apply a pre-use filing requirement to a guest's self-scripted remarks, which likely will be prepared close to the time of his or her appearance. Accordingly, we urge NASD to continue to require post-use filing of the scripted portion of any radio or television show, as under current rules.

⁵ The requirement that television advertisements may not be used until "any changes specified by the Department have been made" seems to assume that a final television advertisement will be virtually identical to its storyboard. This is not always the case. For example, based on the placement of actors in a commercial, disclosure might appear in a slightly different location than it appeared in the storyboard. If a member firm files a storyboard, we request NASD to make clear that, absent unusual circumstances, a final filmed television advertisement may be different from its associated storyboard, provided the differences are not material.

⁶ See Securities Exchange Act Rel. No. 50226 (August 20, 2004) 69 FR 52738 (August 27, 2004) (regarding NASD's pending proposal to apply new presentation and disclosure requirements to fund advertisements that present performance data); Rule 482 under the Securities Act of 1933 (requiring fund advertisements with performance information to comply with additional narrative disclosure and presentation requirements).

⁷ See Rule 2210(c)(5), which requires members new to advertising and members with demonstrated problems regarding advertising to pre-file advertisements, but does not prohibit their use until changes specified by the NASD have been made.

⁸ The NASD previously has recognized the benefits of principal review. See Release 47820 at 27123 (where NASD stated that principal approval of advertisements is vital to ensuring that advertising is fair and balanced). See also NASD Notice to Members 05-27 (April 2005) (NASD proposal to require principal pre-approval of certain correspondence because principal review better ensures that correspondence complies with applicable standards of the advertising rules).

⁹ The SEC previously recognized that it was appropriate to exclude press releases from Rule 2210's filing requirements, agreeing that they are time sensitive and that the filing requirement may represent an unnecessary regulatory burden. See Securities Exchange Act Rel. No. 47820 (May 9, 2003) 68 FR 27116, 27124 (May 19, 2003) ("Release 47820") (SEC approval of changes to modernize and clarify rules governing NASD member communications with the public).

¹⁰ At a minimum, NASD should affirmatively state that when a fund has the ability to control who views a video, such a video is sales literature and, therefore, not subject to the pre-use filing requirement. See [Letter from Frances M. Stadler](#), Deputy Senior Counsel, Investment Company Institute to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated September 17, 2004 (recommending that NASD address the distinction between advertisements and sales literature in connection with any final rule requiring fund advertisements containing performance data to present

certain information in a text box).

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