

**Securities Industry Association**

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October 14, 1997

Ms. Joan Conley
Office of the Corporate Secretary
NASD Regulation, Inc.
1735 K Street, NW
Washington, DC 20006-1500

Re: Notice to Members 97-47

Dear Ms. Conley:

The Investment Company Committee ("the Committee") of the Securities Industry Association ("SIA")¹ is taking this opportunity to respond to NASDR's request for comment on Notice to Members 97-47, a concept release pertaining to the use in fund sales material, of fund manager prior performance in another fund or managed account vehicle which is believed to be sufficiently similar to be of significance to a prospective purchaser of the instant fund. This is commonly referred to as the use of related performance data.

OVERVIEW

As a general matter, the committee is of the strong view that the use of related performance information in sales material should be permitted. We believe that the use of such information, accompanied by appropriate disclosure, is preferable to a continuation of NASDR's current proscriptive approach, or to permitting its use subject to significant limitations not related to appropriate disclosure. This view is premised on our belief that related performance information may be helpful and important for prospective investors to know and understand in connection with considering a mutual fund investment. We also recognize that there are circumstances in which use of performance information other than the particular fund's may be irrelevant or misleading. We believe, however, that the conditions and standards enumerated in the SEC's line of no-action letters in this area are sensible, flexible and appropriate and that funds with circumstances that are consistent with those conditions and standards should be able to use related performance information in sales materials. For example, appropriate related performance may be useful and important when a fund's investment management team experiences significant change. To the extent that any proscriptions are adopted, we believe that they should relate to circumstances that also would clearly run afoul of the SEC's no-action position conditions and standards. For example, the NASDR might prohibit a fund from including performance information

relating to its senior portfolio manager's management of one or more portfolios in a fundamentally different manner. Of course, the manager's performance information also would likely fail to qualify under the SEC's no-action positions as well.

We also believe that as a general matter this is a difficult area in which to adopt new NASDR rules. As evidenced by the SEC's interest and activity in recent years, performance information standards continue to develop over time. The SEC has been in a unique position to deal with changes in practice through its flexible no-action letter process. We believe that even the best-intentioned effort to codify the SEC's current positions in this area will inevitably become out-of-date as industry practice and SEC positions change. Accordingly, we recommend that the NASDR orient its efforts in this area towards ensuring that fund sales materials are consistent with the SEC positions and that no additional rulemaking is necessary for this purpose.

NASDR IMPOSITION OF SPECIFIC DISCLOSURE STANDARDS

As the Notice to members indicates there is no evidence of substantive abuse in this area. Therefore, there is no reason for NASDR to regulate it. If abuses are discovered, particular conduct, not use of related performance data in general, should be proscribed. There is already more than adequate authority under the anti-fraud provisions of the federal securities laws and NASDR's own conduct rules to address improper or abusive conduct with respect to related performance disclosure. These rules and regulations, of course, address both misleading or inaccurate information as well as omission of material facts. To the extent that specific disclosure standards are deemed necessary, they should be "minimum" standards. We believe it would be unwise and ultimately unproductive to attempt to address every aspect of related performance reporting because of the vast number of variables and circumstances that may influence that related performance information. This is why, on balance, a disclosure approach coupled with minimum standards (such as requiring a minimum performance reporting period) is the best alternative, to the extent any measures are taken at all by NASDR. We believe that such an approach would provide investors with sufficient information to make an informed comparison of investment alternatives.

CALCULATION OF PERFORMANCE

We believe that extensive comment on calculation methodology is best left to associations such as the Investment Company Institute, Association for Investment Management and Research, and others whose membership is most significantly involved in issues of performance reporting and calculation.

We do not believe however, that use of the calculation methodology of any particular organization should be imposed by any regulatory entity, and that calculation methodology is also best addressed by appropriate disclosure rather than mandated. This is not to say that such calculation methodologies do not have a role to play, and their usage may contribute toward establishing the adviser's good faith should situations arise where the performance reporting methodology of the adviser is called into question.

INCUBATOR FUNDS

We are of the view that a so-called incubator fund's performance may have appropriate uses, which should be balanced against the potential for such information to be misleading. As noted in the Notice to members, the SEC has developed an approach to incubator fund performance through a series of relatively recent no-action letters. The SEC's positions are designed to avoid the potential for "cherry-picking" among the performance of a number of incubator funds, while acknowledging the legitimate use of performance information under certain circumstances that do not involve formation of a number of such funds merely or primarily to facilitate inclusion of an attractive performance record in a new fund's prospectus or sales material. Accordingly, we again recommend that the NASDR confine itself to ensuring that practice is consistent with the SEC's position. Any NASDR rulemaking in this area should be directed to eliminating clear-cut abuses and/or situations in which the potential to mislead clearly outweighs any value the information might provide to investors.

SUMMARY

The Committee summarizes its views regarding use of related performance data, as follows:

- except for clearly abusive practices, disclosure should be favored over proscription;
- The SEC's no-action letter approach to related performance data issues has proven both adequate and flexible, and amplification through additional NASDR rules is unnecessary.
- use of comparability or calculation methodologies of private organizations should not be required, but their use should be encouraged and properly disclosed to investors;
- use of incubator fund performance reporting should be discouraged in circumstances where "cherry-picking" concerns exist.
- We appreciate the opportunity to comment. If you have any questions concerning the contents of this letter, please do not hesitate to contact me at 212-848-1715 or Michael D. Udoff at 212-618-0509.

Sincerely,

Lawrence H. Kaplan
Chairman
Investment Company Committee

cc:

Joe Price, Esq.
R. Clark Hooper
Douglas Scheidt, Esq.

Footnotes:

1 The Securities Industry Association is the trade association representing more than 780 securities firms headquartered throughout North America. Its members include securities organizations of all types--investment banks, brokers, dealers, specialists, and mutual fund companies. SIA members are active in all markets, and in all phases of corporate and public finance. Collectively, they provide investors with a full spectrum of investment services and account for approximately 90% of the securities industry's revenue in the United States.