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NASD Clears Up Fee Confusion in Text Box Rule

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The NASD has addressed a thorny aspect of its new "text box rule," which spells out requirements for fund firms that illustrate past investment performance in print advertisements.

The regulator recently issued interpretive guidance regarding how fund firms can disclose fees within advertisements. The guidance expands upon the text box rule, which states that fund shops must have clearly displayed text boxes with specific disclosures in advertisements that show past fund performance. For example, the text box must show fees and use a standardized method for calculating investment performance.

The rule, which becomes effective on April 1, had previously stated that fund firms must report fees prior to the impact of waivers on a fund's expense ratio, says Jim Alt, a partner at **Dorsey & Whitney**.



That caused strong concern among some fund industry executives. They reasoned that the requirement would confuse investors because disclosures wouldn't show the reduced fund expenses resulting from fee waivers. That's especially true for investors that may compare information on fees found within fund prospectuses with the information included in advertisements.

"The rule said you could only show fees before waivers," he explains. "To leave the fee waivers out of the box would almost be misleading."

The guidance from the NASD, however, says firms can also include an explanation of fee waivers and the final fees within the text box.

"There was some potential for confusing investors, so that's a good change," Alt says.

The text box rule was adopted by the NASD in July. It is an amendment to NASD Rules 2210 and 2211. Those rules govern communications with the public.

In addition to providing guidelines on reporting fund performance, the regulation states that advertisements must show fees based on the funds' most recent prospectuses. The text box rule also emphasizes that performance information displayed in advertisements must be culled from a fund's most recent regulatory filing, such as an annual or semi-annual report.

Alt points out that some fee waivers are granted by advisors on a voluntary basis. Since the waivers are voluntary, advisors can drop them at any time.

Other fee waivers are a result of negotiations with boards and are specified by contracts. Those waivers can't be removed unless advisors are able to eliminate stipulations requiring the fee discounts that are specified by contracts. The new NASD guidance applies to both forms of waivers, he says.

Alt says the NASD may have decided to provide the new provisions in the guidance after fund firms expressed concerns over the potential confusion that investors may face if they aren't provided information on fee waivers.

The change makes a lot of sense, says Niels Holch, executive director of the Coalition of Mutual Fund Investors. He agrees with Alt's assessment that providing only fees prior to fee waivers could confuse investors.

"It's unfair to say gross fees [fees before the waiver] have to be disclosed without saying you can disclose fees after the waiver," he adds.

The changes have won the endorsement of the ICI, which believes it will lead to effective disclosures of fund expenses in fund advertisements, says Chris Wloszczyna, a spokesman with the organization.

According to the guidance, any print advertisements used on or after April 1 by fund firms and brokers must comply

with the regulation. According to the rule, the text box must be displayed in a prominent location. With that in mind, the NASD guidance provides additional insight into what a prominent location is and other details, such as the appropriate size of text within the box.

Herb Perone, an NASD spokesman, didn't return calls by deadline.

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