

that the tool's algorithm determines have a reasonable probability of occurrence;⁴

(3) the tool uses a mathematical process that can be audited and reviewed;

(4) the member describes the criteria and methodology used, including the investment analysis tool's limitations and key assumptions;

(5) the member explains that results may vary with each use and over time;

(6) the member describes the universe of investments considered in the analysis, explains how the tool determines which securities to select, discloses if the tool favors certain securities⁵ and, if so, explains the reasons for the selectivity, and states that other investments not considered may have characteristics similar or superior to those being analyzed; and

(7) the member displays the following additional disclosure: "IMPORTANT: The projections or other information

⁴ The entire range of investment outcomes would encompass a range of numbers that, as a practical matter, cannot be calculated accurately. The IM therefore requires that the tool, written report of the tool's results or related sales material show the range of possible investment outcomes that the tool's algorithm determines have a reasonable probability of occurrence."

The tool, written report of the tool's results or related sales material must depict a "fair and balanced representation" of this range. A "fair and balanced representation" would include, at a minimum, the "upside," "downside" and "median" projections of estimated outcomes, but would not require a depiction of every outcome in between. Any representation that, in light of all the facts and circumstances, is misleading will not be considered a "fair and balanced representation" of the range. For example, the presentation of a range of possible outcomes skewed to depict only or to weigh in favor of positive market performance would not be a "fair and balanced representation" of the range. In this regard, whenever the tool, written report of the tool's results or related sales material shows an outcome that the investor has a certain chance of achieving on the "upside," the tool, written report, or related sales material must also show the corresponding outcome on the "downside." Moreover, the tool, written report or related sales material should make clear that the dollar amount representing the "downside" is not the worst-case scenario, and it must include a prominent statement of the estimated probability (for example, a "5% chance" or "1 in 20 chance") that the investor will end up with less than the "downside" amount that the tool generates.

⁵ This disclosure must indicate, among other things, whether the investment analysis tool searches, analyzes or in any way favors certain securities within the universe of securities considered based on revenue received by the member in connection with the sale of those securities or based on relationships or understandings between the member and the entity that created the investment analysis tool. The disclosure also must indicate whether the investment analysis tool is limited to searching, analyzing or in any way favoring securities in which the member makes a market or has any other direct or indirect interest. Members are not required to provide a "negative" disclosure (i.e., a disclosure indicating that the tool does not favor certain securities).

generated by [name of investment analysis tool] regarding the probabilities that various investment outcomes might occur are hypothetical in nature, do not reflect actual investment results and are not guarantees of future results. [Name of investment analysis tool] only presents a range of possible outcomes."

(d) Disclosures

The disclosures and other required information discussed in paragraph (c) must be written, clear and prominent.

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II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the NASD included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in item IV below. The NASD has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The NASD proposes to allow NASD member firms to use certain investment analysis tools that show the probability that investing in specific securities or mutual funds may produce a desired result. Under the proposed IM, members could offer investment analysis tools and written reports showing the results of such tools (and use related sales material) only if the tools, reports or sales material present a range of probabilities that various investment outcomes might occur and do not state that a particular investment outcome will, in fact, occur; present a fair and balanced representation of the range of possible investment outcomes that the tool's algorithm determines have a reasonable probability of occurrence; use a mathematical process that can be audited and reviewed; describe the criteria and methodology used, including the tool's limitations and key assumptions; explain that results may vary with each use and over time; and describe the universe of investments considered in the analysis, explain how the tool determines which securities to select, disclose if the tool favors certain securities and, if so, explain the reason for the selectivity, and state that other investments not considered may have

characteristics similar or superior to those being analyzed.

In addition, the following disclosure must be displayed: "Important: The projections or other information generated by [name of investment analysis tool] regarding the probabilities that various investment outcomes might occur are hypothetical in nature, do not reflect actual investment results and are not guarantees of future results. [Name of investment analysis tool] only presents a range of possible outcomes."

The proposed IM also would require members to provide NASD's Advertising Regulation Department with access to the tool (as well as any template for written reports showing the results of the tool or sales material concerning such tool) at least 30 days prior to first use. The review and approval are not merit-based, but rather focus on whether the member has complied with the disclosure requirements and the other requirements of NASD rule 2210, such as the prohibitions on exaggerated, unwarranted and misleading statements and claims. Finally, the IM makes clear that, to the extent that these tools produce recommendations, the NASD's suitability rule would apply.

2. Statutory Basis

The NASD believes that the proposed rule change is consistent with the provisions of section 15A(b)(6)⁵ of the Act, which requires, among other things, that the NASD's rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. As discussed above, the proposed IM requires members to disclose various material aspects of the investment analysis tools and reports that they generate. The proposed IM also would require members to provide access to the tool (as well as any template for written reports showing the results of the tool or sales material concerning such tool) to the Advertising Regulation Department at least 30 days prior to first use. In addition, the proposal reminds firms of their suitability obligations. The NASD believes that these restrictions will enable firms to provide investment analysis tools to investors while making clear to investors the limitations of such tools. As such, the investment analysis tools should allow investors to make educated judgments about how particular strategies or investments might perform.

⁵ 15 U.S.C. 78o-3(b)(6).