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SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 230 and 270

[Release Nos. 33-7513; IC-23065; File No. S7-18-96]

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New Disclosure Option for Open-End Management Investment Companies

AGENCY: Securities and Exchange Commission

ACTION: Final rule

SUMMARY: The Securities and Exchange Commission is adopting a new rule that would permit a mutual fund to offer investors a new disclosure document called a "Aprofile," which summarizes key information about the fund, including the fund's investment strategies, risks, performance, and fees, in a concise, standardized format. A fund that offers a profile will be able to give investors a choice of the amount of information that they wish to consider before making a decision about investing in the fund; investors will have the option of purchasing the fund's shares after reviewing the information in the profile or after requesting and reviewing the fund's prospectus (and other information). An investor deciding to purchase fund shares based on the information in a profile will receive the fund's prospectus with the confirmation of purchase.

DATES: Effective on June 1, 1998.

FOR FURTHER INFORMATION CONTACT: Kathleen K. Clarke, Assistant Director, George J. Zornada, Team Leader, or Laura J. Riegel, Attorney, (202) 942-0721, Office of Disclosure Regulation, Division of Investment Management, Securities and Exchange Commission, 450 Fifth Street, N.W., Mail Stop 5-6, Washington, D.C. 20549-6009. Contact the Office of Chief Counsel, Division of Investment Management, Securities and Exchange Commission, at (202) 942-0659 or 450 Fifth Street, N.W., Mail Stop 5-6, Washington, D.C. 20549-6009 for additional information, including interpretive guidance, relating to this release or the profile.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission (the "Commission") today is adopting new rule 498 [17 CFR 230.498] under the Securities Act of 1933 [15 U.S.C. 77a, *et seq.*] ("Securities Act") and the Investment Company Act of 1940 [15 U.S.C. 80a-1, *et seq.*] ("Investment

Company Act"). Rule 498 permits an open-end management investment company that registers on Form N-1A [17 CFR 274.11A] (a "fund") to provide to investors a disclosure document called a "profile," which summarizes key information about the fund and gives investors the option of purchasing the fund's shares based on the information in the profile. The Commission also is adopting amendments to rule 497 under the Securities Act [17 CFR 230.497] to require a fund to file a profile with the Commission at least 30 days prior to the profile's first use. In a companion release, the Commission is adopting revisions to the prospectus disclosure requirements in Form N-1A, the registration statement used by funds.¹ These revisions seek to minimize prospectus disclosure about technical, legal, and operational matters that generally are common to all funds and to focus prospectus disclosure on essential information about a particular fund that would assist an investor in making a decision about investing in that fund.

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I. Introduction and Background

Over the last decade, the fund industry has grown tremendously. Over 6,000 funds are now available to investors and close to 40 million American households own funds.²

¹ Investment Company Act Release No. 23064 (Mar. 13, 1998) ("Form N-1A Release").

² See INVESTMENT COMPANY INSTITUTE ("ICI"), Trends in Mutual Fund Investing: September 1997 at 3 (Oct. 30, 1997) (ICI News No.

Today, fund assets exceed the deposits of commercial banks.³

As more investors turn to funds for professional management of current and retirement savings, funds have introduced new investment options and shareholder services to meet the needs of investors. While benefiting from these developments, investors also face an increasingly difficult task in choosing among different fund investments. The Commission, fund investors, and others have recognized the need to improve fund disclosure documents to help investors evaluate and compare funds.⁴ In the Commission's view, the growth of the fund industry and the diversity of fund investors warrant a new approach to fund disclosure that will offer more choices in the format and amount of information available about fund investments.⁵

97-93) ("ICI Trends") (as of Sept. 1997, there were 6,666 funds) and ICI, Mutual Fund Ownership in the U.S., FUNDAMENTALS, Dec. 1996, at 1 (approximately 36.8 million households owned mutual funds either directly or through a retirement plan as of April 1996).

³ Compare ICI Trends at 1 (fund net assets exceeded \$4.4 trillion as of Sept. 1997) with Federal Reserve Bank Statistical Release H.8: Assets and Liabilities of Commercial Banks in the United States (Nov. 7, 1997) (commercial bank deposits were approximately \$3.0 trillion as of Oct. 1997).

⁴ See, e.g., "Fulfilling the Promise of Disclosure," Remarks by Arthur Levitt, Chairman, SEC, before the American Savings Education Council, New York, NY (July 23, 1997); Remarks by Steven M.H. Wallman, Commissioner, SEC, before the ICI's 1995 Investment Company Directors Conference and New Directors Workshop, Wash., D.C. (Sept. 22, 1995); "Mutual Funds and the International Marketplace: A Regulatory Challenge," Remarks by Isaac C. Hunt, Jr., Commissioner, SEC, before the Sixth Annual Conference on International Issues, The University of Tulsa, Tulsa, Okla. (Mar. 6, 1997). See also McTague, Simply Beautiful: Shorn of Legalese, Even Prospectuses Make Sense, BARRON'S, Oct. 7, 1996, at F10 (concerning the recent efforts of the John Hancock funds and other fund groups to simplify their prospectuses).

⁵ The Commission has demonstrated an on-going commitment to improve the information provided in fund disclosure documents to meet changes in the fund industry and investors' needs. The Commission has taken a number of steps in recent years to meet this goal. See Investment Company Act Release No. 20974 (Mar. 29, 1995) [60 FR 17172] (requesting comment on ways to improve risk disclosure and comparability of fund risk levels) ("Risk Concept Release"); Investment Company Act Release No. 19382 (Apr. 6, 1993) [58 FR 19050] (simplifying financial highlights information and requiring management's discussion of fund performance ("MDFP")); Investment Company Act Release No. 16245 (Feb. 2, 1988) [53 FR 3868] ("Fund Performance Release") (adopting a uniform formula for calculating fund performance); Investment Company Act Release No. 16244 (Feb. 1, 1988) [53 FR 3182] (adopting a uniform fee table in fund prospectuses). See also SEC, REPORT OF THE ADVISORY COMMITTEE ON THE CAPITAL FORMATION AND REGULATORY PROCESSES (July 24, 1996); SEC, REPORT OF THE TASK FORCE ON DISCLOSURE SIMPLIFICATION (1996) (recommending specific improvements in the disclosure provided by corporate issuers).

In seeking to meet this goal, the Commission proposed, on February 27, 1997, new rule 498, which would permit a fund to provide investors with a profile (the "Proposed Profile").⁶ The Proposed Profile would summarize key information about a fund, including the fund's investment objectives, strategies, risks, performance, fees, investment adviser and portfolio manager, purchase and redemption procedures, distributions, and the services available to the fund's investors. The Proposed Profile was designed to provide summary information about a fund that would assist an investor in deciding whether to invest in a fund or to request additional information about the fund before deciding whether to buy shares in that fund. Proposed rule 498 would require a fund to mail the prospectus and other information to the requesting investor within 3 business days of a request. An investor deciding to purchase fund shares based on the Proposed Profile would receive the fund's prospectus with the purchase confirmation.

On the same day that it proposed rule 498 for comment, the Commission published a release in which it proposed major changes to the prospectus disclosure requirements in Form N-1A ("Form N-1A Proposing Release").⁷ The proposed amendments to Form N-1A were designed to focus prospectus disclosure on essential information about a particular fund that would assist an investor in making a decision about investing in that fund. The proposed amendments reflected the Commission's strongly-held belief that a prospectus, as the primary disclosure document contemplated under the federal securities laws, should present clear, concise, and understandable information about an investment in a fund.

The Proposed Profile was based on a number of initiatives undertaken by the Commission to assess options for improving fund disclosure documents. One of these initiatives was a pilot program conducted by the Commission, with participation by the Investment Company Institute ("ICI") and several large fund groups, in which the funds used profile-like summaries ("Pilot Profiles") with their prospectuses.⁸ The

Pilot Profiles, like the profile adopted today, summarized important information about funds. The purpose of the pilot program was to assess whether investors found the Pilot Profiles helpful in making investment decisions. Focus groups conducted on the Commission's behalf ("Focus Groups") responded positively to the profile concept, indicating that a disclosure document such as the Pilot Profile would assist them in making investment decisions. Fund investors participating in a survey sponsored by the ICI also strongly supported the Pilot Profiles.⁹

The Commission received 256 comment letters on the Proposed Profile, a large percentage of which were from individual investors (226 letters or 88%).¹⁰ Commenters expressed strong support for the Proposed Profile.¹¹ Many commenters cited the advantages of a document that is less technical and easier to read. Commenters believed that the Proposed Profile would assist investors in selecting a fund in which to invest. Many of those commenting on the Proposed Profile, particularly individual investors, endorsed the Proposed Profile's goal of providing standardized, summary information about a fund.¹²

The Commission is adopting rule 498 with modifications that reflect the Commission's consideration of commenters' suggestions. Rule 498 permits a fund to provide investors with a new disclosure option in the form of a profile that summarizes key information about the fund.¹³ A fund

Management ("Division") has permitted the pilot program to continue until adoption of proposed rule 498. See Investment Company Institute (pub. avail. July 16, 1997) ("1997 Profile Letter").

⁹Letter from Paul Schott Stevens, Senior Vice President and General Counsel, ICI, to Barry P. Barbash, Director, Division of Investment Management, SEC, at 5-6 (May 20, 1996) ("ICI Survey Letter") (enclosing Investment Company Institute, The Profile Prospectus: An Assessment by Mutual Fund Shareholders (1996) (survey of over 1,000 fund investors) ("ICI Profile Survey")).

¹⁰In addition to the comment letters from individuals, the Commission received comment letters from 6 broker-dealers and investment advisers, 8 funds, 3 law firms, 1 rating agency, 4 trade associations, and 8 other interested organizations. The comment letters, as well as a comment summary prepared by the Commission's staff, are available for public inspection and copying at the Commission's public reference room in File No. S7-18-96.

¹¹Of the comment letters received by the Commission, 88% supported the Proposed Profile.

¹²See also Middleton, Cure on the Way for * * * Prospectusphobia, Mutual Funds Magazine, June 1997, at 58; Fosback, Profiles—A Valuable New Tool for Investors, Mutual Funds Magazine, May 1997, at 10; Profile Prospectuses: An Idea Whose Time Has Come, Mutual Funds Magazine, Aug. 1996, at 11.

¹³The ICI recently conducted a survey to assess information that investors considered before making a fund purchase. The results indicated that

that makes a profile available will be able to offer an investor the option of purchasing the fund's shares after reviewing the information in the profile or of requesting and reviewing the fund's prospectus (and other information) before making an investment decision. An investor deciding to purchase fund shares based on the profile will receive the fund's prospectus with the purchase confirmation.

Under rule 498, as adopted, the profile will include:

—*Standardized Fund Summaries.* The profile includes concise disclosure of 9 items of key information about a fund in a specific sequence.

—*Improved Risk Disclosure.* A risk/return summary (also required at the beginning of a fund's prospectus) provides information about a fund's investment objectives, principal strategies, risks, performance, and fees.

—*Graphic Disclosure of Variability of Returns.* The risk/return summary provides a bar chart of a fund's annual returns over a 10-year period that illustrates the variability of those returns and gives investors some idea of the risks of an investment in the fund. To help investors evaluate a fund's risks and returns relative to "the market," a table accompanying the bar chart compares the fund's average annual returns for 1-, 5-, and 10-year periods to that of a broad-based securities market index.

—*Other Fund Information.* The profile includes information on the fund's investment adviser and portfolio manager, purchase and redemption procedures, tax considerations, and shareholder services.

—*Plain English Disclosure.* The Commission's recently adopted plain English disclosure requirements, which are designed to give investors understandable disclosure documents, will apply to the profile.¹⁴ The Commission's plain English rule requires the use of plain English writing principles, including short sentences, everyday language, active voice, tabular presentation of complex

investors considered fund risk levels, total returns, and investment goals most frequently (listed respectively as first, second, and fourth). ICI, Understanding Shareholders' Use of Information and Advisers at 4 (1997) ("ICI Shareholder Survey").

¹⁴See Securities Act Release No. 7497 (Jan. 28, 1998) [63 FR 6370] ("Plain English Release") (adopting amendments to rule 421 under the Securities Act [17 CFR 230.421] requiring the use of plain English disclosure principles).

⁶Investment Company Act Release No. 22529 (Feb. 27, 1997) [62 FR 10943], correction [62 FR 24160] ("Profile Proposing Release").

⁷Investment Company Act Release No. 22528 (Feb. 27, 1997) [62 FR 10898], correction [62 FR 24160] ("Form N-1A Proposing Release").

⁸See Investment Company Institute (pub. avail. July 31, 1995) ("1995 Profile Letter"); Investment Company Institute (pub. avail. July 29, 1996) ("1996 Profile Letter"). The Division of Investment

material, no legal or business jargon, and no multiple negatives.¹⁵

Rule 498, as adopted, also permits a fund that serves as an investment option for a participant-directed defined contribution plan (or for certain other tax-deferred arrangements) to provide investors with a profile that includes disclosure that is tailored for the plan (or other arrangement). Profiles tailored for such use can exclude information relating to the purchase and sale of fund shares, fund distributions, tax consequences, and fund services otherwise required in a profile.

The Commission has determined to adopt rule 498 and permit funds to use summary disclosure documents in accordance with the rule under the authority of section 10(b) of the Securities Act¹⁶ and other provisions of the federal securities laws.¹⁷ Section 10(b) gives the Commission the authority to adopt rules allowing the use of a summary prospectus if the Commission determines that doing so is "necessary or appropriate in the public interest and for the protection of investors."¹⁸ In making this determination about profiles, the Commission considered, among other things: An extensive analysis of fund disclosure issues it recently conducted; its assessment of funds' use of Pilot Profiles; its assessment of certain other disclosure initiatives; and its substantial experience gained in administering the two-part disclosure format adopted in 1983 permitting a fund to provide investors with a simplified prospectus containing essential information about the fund and to place more detailed information about the fund in a Statement of Additional Information ("SAI"), which investors can obtain

upon request.¹⁹ The Commission believes, and the broad support for the Proposed Profile confirms its belief, that rule 498 will benefit investors and promote effective communication of information about funds.

Today, the Commission also is adopting the proposed amendments to Form N-1A.²⁰ As they did with the Proposed Profile, commenters strongly supported the revised prospectus disclosure requirements. Taken together, these two disclosure initiatives are intended to allow funds flexibility to respond to the diverse information needs of investors and to improve fund disclosure.²¹

II. DISCUSSION

A. General

1. Overview of Comments

The vast majority of commenters on the Proposed Profile expressed strong support for the profile and specifically supported the concept of giving investors the option of purchasing shares of a fund on the basis of information contained in a summary disclosure document.²² A small number of commenters, however, questioned whether providing investors with this

option was in the best interests of fund investors. These commenters asserted that investors may not appreciate the significance of an investment in a fund if they purchase its shares based on a summary document rather than the prospectus. These commenters also were concerned that widespread use of a profile could cause fewer investors to read the prospectus and asserted that the Commission would be better advised to direct its efforts to improving the prospectus.

Implicit in these comments would seem to be the view that all investors should use a longer document—the prospectus—rather than a shorter document—the profile—in making a decision about investing in a fund. Such a view appears to be inconsistent with the sentiments of fund investors. The Commission and others, in seeking to identify ways to improve the disclosure of information about mutual funds to investors, have collected data about investors. This data demonstrates that different investors desire and use different types and amounts of materials in determining whether to invest in funds.²³ The Commission believes that the data supports its conclusion to allow funds the option of offering their shares through the profile with delivery of a prospectus with the confirmation of purchase.

The Commission's strongly held belief is that the principal goal of fund disclosure, whether it takes the form of a long or short document, should be to provide investors with useful and relevant information. Each of the disclosure initiatives that the Commission is adopting today has this goal, which the Commission believes complements the themes underlying the recently adopted plain English rule.²⁴ To further this goal, the Commission encourages all funds that decide to use profiles to take the steps necessary to ensure that their prospectuses effectively communicate information to investors. The Commission believes that funds need to take this action if the initiatives adopted today are to achieve their objectives.

2. Liability

In its release proposing new rule 498 ("the Profile Proposing Release"), the Commission discussed the protections

¹⁵ Rule 421(d).

¹⁶ 15 U.S.C. 77j(b). Section 10(b) of the Securities Act of 1933 ("Securities Act") permits the use of a summary prospectus (which provides information the substance of which is included in the prospectus) to communicate information for purposes of an offer under section 5(b)(1) of the Securities Act [15 U.S.C. 77e(b)(1)]. Section 5(b)(2) of the Securities Act [15 U.S.C. 77e(b)(2)] requires, as a condition of selling a security, the delivery to investors of a prospectus that meets the requirements of section 10(a) of the Securities Act [15 U.S.C. 77j(a)].

¹⁷ Congress recently confirmed the authority of the Commission to permit the use of a summary prospectus by adding new section 24(g) to the Investment Company Act [15 U.S.C. 80a-24(g)]. National Securities Markets Improvement Act of 1996, Pub. L. 104-290 (1996) ("Improvements Act"), section 204 (amending section 24 to add new paragraph (g)). While the profile, as adopted, will include a summary of information that is required in the prospectus, the Commission may adopt other rules under section 24(g) allowing a fund to use a summary prospectus that includes information the substance of which is not included in the prospectus.

¹⁸ See *supra* note 16.

¹⁹ Investment Company Act Release No. 13436 (Aug. 12, 1983) [48 FR 37928] ("1983 Form N-1A Adopting Release"). See also *supra* note 5.

²⁰ See Form N-1A Release, *supra* note 1.

²¹ The Commission also proposed as part of these disclosure initiatives a new rule to address investment company names that are likely to mislead investors about the investments and risks of an investment company. Investment Company Act Release No. 22530 (Feb. 27, 1997) [62 FR 10955], correction [62 FR 24161]. The proposed rule would require, among other things, funds and other registered investment companies with names suggesting a specific investment emphasis to invest at least 80% of their assets in the type of investment suggested by their name. The Commission received a number of substantive comments on the proposed rule, many of which asserted that the proposal had flaws that the Commission should address. The Division is analyzing the comments and expects to recommend a final rule for Commission consideration in the near future.

²² The Commission has long encouraged summary prospectuses under section 10(b) of the Securities Act to provide investors with a condensed statement of important information included in the prospectus. In 1956, the Commission adopted a rule permitting the use of a summary prospectus under section 10(b), which was extended to investment companies in 1972. See Securities Act Release No. 3722 (Nov. 23, 1956) (adopting rule 434A [17 CFR 230.434A] to permit the use of a summary prospectus); Securities Act Release No. 5248 (May 9, 1972) [37 FR 10071] (extending rule 434A to investment companies); Securities Act Release No. 6383 (Mar. 3, 1982) [47 FR 11380] (renumbering rule 434A as rule 431) [17 CFR 230.431]. The profile permitted by rule 498 is intended to replace the summary prospectuses that funds are currently permitted to use by rule 431 under the Securities Act, and the Commission is amending rule 431 to clarify that the rule no longer applies to funds. The Commission also is eliminating the "Instructions as to Summary Prospectuses" that now accompany Form N-1A. See Form N-1A Release, *supra* note 1.

²³ As noted above, Focus Groups responded very positively to the profile option. A number of individual investors also have written to the Commission and expressed strong support for the profile. See Profile Proposing Release, *supra* note 6, at 10944. See also ICI Profile Survey, *supra* note 9, at 22, 26; ICI Shareholder Survey, *supra* note 13, at 4.

²⁴ See Plain English Release, *supra* note 14.

afforded investors under the federal securities laws for false and misleading statements in a profile.²⁵ These protections include the provisions of sections 12(a)(2) and 17(a) of the Securities Act, which impose civil and criminal liability upon any person who offers or sells securities using an untrue statement of material fact or who omits to state a material fact necessary in order to make a statement, in light of the circumstances under which it was made, not misleading.²⁶ Investor protections applicable to a profile also include the antifraud provisions of section 10(b) of the Securities Exchange Act of 1934 and rule 10b-5 under that Act.²⁷

When it gave the Commission the authority to permit the use of a summary prospectus under section 10(b) of the Securities Act, Congress provided a specific exception from strict liability for misleading statements and omissions imposed under section 11 of the Securities Act²⁸ for these type of disclosure documents. The purpose of the exception was to encourage the use of a summary prospectus while maintaining investor protection by requiring delivery of a section 10(a) prospectus at or before the time that the investor receives the confirmation of the purchase of the security described in the summary prospectus.²⁹

The Commission believes that the profile fits squarely within the statutory framework contemplated by Congress for the offering and sale of securities under the federal securities laws. The profile of a fund will be a summary prospectus under section 10(b) of the Securities Act, but the fund's section 10(a) prospectus will remain the primary disclosure document under the federal securities laws. To inform investors about the availability of the

prospectus, a profile includes a legend on the cover page (or at the beginning of the profile) explaining that the profile is a summary document and stating that more information about the fund is available in the prospectus.³⁰

While most commenters strongly favored the profile, several commenters expressed concern that a fund using a profile could face increased liability under the federal securities laws. These commenters argued in particular that a fund's use of a profile could result in claims under section 12(a)(2) of the Securities Act alleging that the profile is misleading because it omits information disclosed in the fund's prospectus.³¹

To address this concern, several commenters urged the Commission to permit funds to incorporate by reference the prospectus into the profile to provide funds with a defense against unwarranted claims that a profile omits material information. As stated in the Profile Proposing Release, however, the Commission believes that allowing funds to incorporate by reference the prospectus into the profile would be inconsistent with the purpose of the profile and not in the public interest.³²

³⁰ The legend also indicates that other information about the fund is available in addition to the prospectus. See *infra* Section II.B.1 for a discussion of the profile legend.

³¹ Section 12(a)(2) imposes liability for material misstatements or omissions when the seller cannot demonstrate the exercise of "reasonable care." An action under section 12(a)(2) does not require proof of scienter (i.e., intent to mislead investors), e.g., *Wigand v. Flo-Tek, Inc.*, 609 F.2d 1028, 1034 (2d Cir. 1979), or investor reliance on a misleading statement or omission, e.g., *MidAmerica Fed. S. & L. Assoc. v. Shearson/American Express, Inc.*, 886 F.2d 1249, 1256 (10th Cir. 1989); *Sanders v. John Nuveen & Co.*, 619 F.2d 1222, 1225 (7th Cir. 1980), cert. denied, 450 U.S. 1005 (1981). In contrast, claims by private plaintiffs under the antifraud provisions of section 10(b) of the Securities Exchange Act of 1934 ("Securities Exchange Act") require proof of scienter and investor reliance. Under either type of claim, however, it must be established that the misrepresentation or omission was "material," which generally means that a substantial likelihood exists that a reasonable investor would consider the information important in making an investment decision. *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976); *Basic, Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988). Commenters cited several cases as examples of the claims funds may face under section 12(a)(2) for alleged nondisclosures in profiles. See, e.g., *In re TCW/DW North Am. Gov. Income Trust Secs. Litigation*, 941 F. Supp. 326, 337-38 (S.D.N.Y. 1996) (dismissing certain allegations that fund misstated and omitted information regarding risks of international investing on the basis that a reasonable investor would not have been misled); *In Re Alliance North Am. Gov. Income Trust, Inc. Secs. Litigation*, 1996 U.S. Dist. LEXIS 14209 (S.D.N.Y. 1996) (same); *Tabankin v. Kemper Short-Term Global Income Fund*, 1994 U.S. Dist. LEXIS 965 (N.D.Ill. 1994) (dismissing allegations that fund failed to disclose adequately the risks of investment).

³² Profile Proposing Release, *supra* note 6, at 10950. One commenter suggested as an alternative to incorporation by reference that the Commission

The profile is designed to provide summary information about a fund in a self-contained format that will assist an investor in deciding to invest in, or in deciding to request additional information about, the fund. Permitting a fund to incorporate by reference the prospectus into the profile would result in the prospectus being considered a part of the profile and would be inconsistent with the profile being a self-contained document.³³

On the basis of, among other things, its prior experience with summary documents, such as advertisements designed to meet the requirements of rule 482 under the Securities Act,³⁴ the Commission does not agree with commenters' claims that the use of profiles will lead to significant potential liabilities under the federal securities laws. In the Commission's view, a fund using a profile generally should not face liability for omitting information included in the fund's prospectus if the profile includes the information required or permitted by rule 498; potential liability would arise only if a profile contains a material misstatement or omits a statement necessary to make the disclosure in the profile not materially misleading. The mere omission of information from the profile that is required or permitted in the prospectus should not, in the Commission's view, give rise to liability under the federal securities laws.³⁵

create a liability "safe harbor" for funds using profiles. Under such a provision, a fund using a profile meeting the requirements of rule 498 would be deemed to have disclosed all material information about a fund for purposes of the profile if the fund's prospectus contained all material information. Such a provision, in effect, would amount to incorporation by reference and, in the Commission's view, would be inconsistent with the purpose of the profile.

³³ See *White v. Melton*, 757 F. Supp. 267, 271-72 (S.D.N.Y. 1991). See also 1983 Form N-1A Adopting Release, *supra* note 19, at 37930.

³⁴ In 1979, the Commission adopted rule 434d under the Securities Act [17 CFR 230.434d], subsequently redesignated rule 482 [17 CFR 230.482], which permits investment companies to use advertisements that are designed to be omitting prospectuses of the type contemplated by section 10(b) of the Securities Act. Securities Act Release No. 6116 (Aug. 31, 1979) [44 FR 52816].

³⁵ Like those commenting on the Proposed Profile, commenters on proposed rule 434d argued that a fund using an advertisement under the rule would be subject to potential liability under section 12(a)(2) if the advertisement did not contain all of the information included in the fund's prospectus. In adopting rule 434d, the Commission stated its belief that a fund should not be liable under section 12(a)(2) merely because information included in the fund's section 10(a) prospectus was not included in the advertisement. 44 FR at 52817. The Commission is not aware of any lawsuits brought since the adoption of rule 434d in which a fund was found liable for an advertisement meeting the requirements of the rule on the basis that the

Continued

²⁵ See Profile Proposing Release, *supra* note 6, at 10950.

²⁶ 15 U.S.C. 771(a)(2); 15 U.S.C. 77q(a).

²⁷ 15 U.S.C. 78j(b); 17 CFR 240.10b-5. In addition, the Commission has the authority under section 10(b) of the Securities Act to suspend the use of a profile, as a summary prospectus, if the profile includes a false or misleading statement or omits to state a material fact necessary in order to make the statements, in light of the circumstances under which they were made, not misleading. This authority supplements the Commission's authority under section 8(b) of the Securities Act [15 U.S.C. 77h(b)] to issue an order to stop the sale of securities by means of a materially inaccurate or incomplete section 10(a) prospectus.

²⁸ 15 U.S.C. 77k.

²⁹ See I LOSS & SELIGMAN, SECURITIES REGULATION 480 and n.214 (3d ed. 1989) (citing S. Rep. 1036, 83d Cong., 2d Sess. 17-18 (1954) and H.R. Rep. 1542, 83d Cong., 2d Sess. 26 (1954)). Although section 11 liability would not apply to the profile, section 11 liability would apply to the sale of a fund's securities if a misleading statement is included in both the profile and the prospectus.

The Commission believes that the intended purpose of a profile as a summary disclosure document supports the view that a fund using a profile should not be subject to liability under the federal securities laws for omitting information from the profile that is included in the fund's prospectus. Rule 498 specifies the information that can or must be included in a fund's profile and requires the fund to state that the profile contains a summary of certain information in the fund's prospectus. The Commission's goal in adopting rule 498, which is to facilitate the use of a short, summary disclosure document that investors can use to evaluate and compare funds, would not be met unless rule 498 is read as limiting the information required to be included in the profile.

Commenters on the Proposed Profile requested that the Commission provide guidance about the applicability of section 19(a) of the Securities Act to a fund that uses a profile under new rule 498. By its terms, section 19(a) protects a defendant from liability for actions taken in good faith in conformity with any rule of the Commission.³⁶ The Commission believes that a fund that provides investors with a profile in good faith compliance with rule 498 would be able to rely on section 19(a) against a claim that its profile did not include information that is disclosed in the fund's prospectus.

3. Plain English Disclosure

In seeking to encourage all issuers, including funds, to provide disclosure materials required under the federal securities laws that are simpler, clearer, and more useful to investors, the Commission recently adopted initiatives that would require the use of plain English in drafting those materials.³⁷ These initiatives contemplate disclosure documents using plain English writing principles including short sentences, everyday language, active voice, tabular presentation of complex material, no legal or business jargon, and no multiple negatives. The Commission strongly believes that, by drafting profiles in strict compliance with plain English principles, funds can provide improved disclosure to investors. Rule 498, as adopted, reflects this belief. The rule

requires that funds disclose the information in the profile using the plain English writing principles set out in the Commission's plain English rule.³⁸

4. Use of the Profile by Other Types of Investment Companies

The Commission proposed to permit funds to use profiles, but did not propose to permit other types of investment companies, such as closed-end investment companies, unit investment trusts, and separate accounts that offer variable annuities, to rely on rule 498. Several commenters disagreed with the Commission's decision and urged the Commission to allow other types of investment companies to use profiles. The Commission is not persuaded at this time by these commenters, and rule 498, as adopted, is available only to funds. Although it recognizes that a short, summary disclosure document such as the profile could potentially benefit investors in other types of investment companies, the Commission has concluded that it should assess the use of profiles by funds over a period of time before considering a rule that would allow other types of investment companies to use similar summary documents. As the Commission gains experience with funds' use of the profile and analyzes the results of other pilot profile programs that are underway,³⁹ it will consider expanding use of the concept to other types of investment companies.⁴⁰

5. Standardized Format

The Proposed Profile required disclosure of 9 items of key information presented in a specific sequence following a question-and-answer format. The purpose of standardizing the order of the items was to help investors locate similar information in the profiles of

different funds and compare the funds. The proposed question-and-answer format, frequently used by many funds in their prospectuses, was intended to help communicate the required information effectively. Most commenters supported a standardized presentation in profiles, but several commenters criticized the prescribed question-and-answer format, suggesting that funds should be able to choose other formats to set out the information required in a profile. The Commission is adopting the standardized presentation requirement as proposed because it believes that requiring the profile items in a specific sequence will substantially assist investors in locating information and comparing funds. Consistent with the goal of allowing funds to design effective disclosure documents, however, rule 498 does not limit the presentation of the required information to a question-and-answer format.⁴¹ Any fund that chose to do so could use a question-and-answer format in its profile.

6. Additional Disclosure Items

Several commenters suggested that additional disclosure items would be useful in a profile, including:

- a fund's top ten portfolio holdings;
- an investment style box;
- additional measures of risk; and
- financial highlights.

The Commission acknowledges that the disclosure suggested by the commenters could be useful to some fund investors and could generally enhance the information available about funds. Nonetheless, the Commission has concluded that none of these items should be required by rule 498 at this time.

In considering fund disclosure requirements, the Commission must balance many factors, including, among other things, the amount of information that is consistent with the purpose of a particular disclosure document. The purpose of the profile is to provide investors with a short, standardized disclosure document containing summary information about a fund. In the Commission's view, the additional items suggested by commenters could be of interest to some fund investors but are not necessarily essential information for the average or typical investor. The Commission believes that some of the

advertisement failed to include information contained in the fund's prospectus.

³⁶ 15 U.S.C. 77s(a). See also section 38(c) of the Investment Company Act [15 U.S.C. 80a-37(c)].

³⁷ See Plain English Release, *supra* note 14. As part of the plain English initiatives, the Commission plans to issue A Handbook on Plain English: How to Create Clear SEC Disclosure Documents, prepared by the Commission's Office of Investor Education and Assistance.

³⁸ Instruction 2 to rule 498(b) (requiring funds to use the plain English writing principles set out in rule 421(d) in drafting the disclosure in the profile). See *supra* note 14 and accompanying text.

³⁹ See National Association for Variable Annuities (pub. avail. June 4, 1996) (staff no-action letter allowing pilot program for variable annuity profiles). The Division has permitted this program to continue pending its taking any further action with respect to variable annuity profiles. National Association for Variable Annuities (pub. avail. May 30, 1997) (staff no-action letter).

⁴⁰ The Proposed Profile refined the prototype profile used in the pilot program, which allowed the Commission to evaluate use of the profile concept for funds. See *supra* note 8 and accompanying text. The Commission believes that further initiatives to adapt the profile concept for other types of investment companies should follow a similar approach that includes a review of existing prospectus disclosure requirements and an assessment of investor responses to a different disclosure format.

⁴¹ The profile is, however, subject to certain other format requirements. Under rule 498, as adopted, profiles must meet requirements with respect to font size and legibility set out in rule 420 under the Securities Act [17 CFR 230.420]. Rule 420 requires, among other things, that prospectuses be in roman type at least as large and as legible as 10-point modern type.

types of information cited by commenters may be more helpful in connection with a fund's discussion of its current investment activities that is presently included in fund shareholder reports.⁴² The Commission has directed the Division of Investment Management ("Division") to begin work on a comprehensive assessment of the Commission's existing rules specifying the disclosure to be included in fund reports to shareholders to assess whether other types of information should be added to those reports.⁴³

7. Eligibility

In the Profile Proposing Release, the Commission suggested that certain funds might not be eligible to use a profile. In particular, the Commission stated that, if material information about a fund exists but is not addressed by the 9 items of disclosure required to be in a profile, the fund might not appropriately use a profile.⁴⁴ Several commenters strongly objected to this assertion. They argued that it is inconsistent with the premise underlying the profile initiative that a typical fund investor would have enough information to make an investment decision about a fund using a summary disclosure document containing the 9 required items accompanied by a statement about the availability of additional information in the fund's prospectus and other documents. One commenter suggested that the Commission address the eligibility issue by requiring the profile to provide additional summary information about other items of disclosure that are required in prospectuses. Another commenter suggested that, as an alternative, the Commission provide for a tenth item in

the profile in response to which a fund could include at its option any other information that the fund believed was material to an investor's consideration of an investment in the fund. Several other commenters, however, argued that such an item was not consistent with the Commission's purpose in developing the Proposed Profile as a short, standardized, self-contained disclosure document.

After consideration of these comments, the Commission has determined to adopt rule 498 to require funds to include only the information specified by the 9 items in the rule and to delete any suggestion that certain funds may be ineligible to use profiles.⁴⁵ The Commission has selected these items because it believes that they fulfill the goal of providing investors with a short, summary disclosure document on the basis of which investors can make decisions about investing in a fund. Under rule 498, as adopted, an investor who believes that he or she needs more information before making such a decision has the option of obtaining additional information by requesting the fund's prospectus or other disclosure materials.⁴⁶

⁴⁵ Rule 498(b). The profile generally will provide a summary of certain items in the prospectus, while the prospectus will provide a fuller description of each of these items. The prospectus, for example, discloses the amount of any rule 12b-1 fees charged by a fund in the fee table and includes a narrative discussion about the fund's rule 12b-1 fees. In contrast, the profile as a summary disclosure document discloses the amount of the fund's rule 12b-1 fees as part of the fee table disclosure. Similarly, a prospectus identifies each investment adviser of a fund, including a sub-adviser of the fund, while, in certain cases, a profile could disclose the number of sub-advisers managing the fund's portfolio without identifying each sub-adviser. See Form N-1A Release, *supra* note 1, and *infra* notes 90 and 93-94 and accompanying text.

⁴⁶ Proposed rule 498 provided that a fund could not use footnotes or include cross-references within the profile or to information appearing in another of the fund's disclosure documents, unless specifically required or permitted in the rule. See Profile Proposing Release, *supra* note 6, at 10945 n.22. The Commission believes that footnotes and cross-references should generally be unnecessary in a summary document such as a profile. The Commission acknowledges, however, that circumstances may exist under which footnotes or cross-references within the profile may result in better disclosure. Thus, the Commission is revising rule 498 to discourage, but not to preclude, the use of footnotes or cross-references within a profile; under the rule, a fund may use footnotes or cross-references within a profile if their use promotes a better understanding of the information about the fund contained in the profile. Instruction 1 to rule 498(b). Rule 498, as adopted, continues to preclude use of cross-references to information appearing in another of the fund's disclosure documents. Such cross-references would be inconsistent with the purpose that the profile be a self-contained document. For purposes of the profile only, a hyperlink to a fund's prospectus from the fund's profile when both documents are available electronically would not be deemed a cross-

8. Number of Funds Described in a Profile

Rule 498, as proposed, would permit a profile to describe more than one fund. As discussed in the Profile Proposing Release, the Commission concluded, on the basis of the Pilot Program and Focus Group responses, that a profile that describes more than one fund can be consistent with the goal of a summary disclosure document that assists investors in evaluating and comparing funds. Describing more than one fund or class in a profile, for example, could be a useful means of providing investors with information about related investment alternatives offered by a fund group (e.g., a range of tax-exempt funds or different types of money market funds) or about the classes of a multiple class fund.

Recognizing that too much information could make the profile lengthy, complex, and difficult to understand, the Commission requested comment whether use of a profile should be limited to one fund or to some other number of funds. Most commenters supported the proposal to allow a profile to describe more than one fund. One commenter expressed concerns about the proposal and suggested that funds instead be allowed to bind separate profiles together.

The Commission believes that the ability to describe different investment options in one summary document will enable funds to develop profiles that help investors compare investment alternatives offered by a fund group. Therefore, the Commission is adopting rule 498, as proposed, with no express limitation on the number of funds that can be described in a profile. Information about multiple funds in a single profile, however, would need to be set out in a concise and summary manner in a format designed to communicate the information effectively.⁴⁷

B. Profile Disclosure

1. Cover Page

Proposed rule 498 would require the cover page of a fund's profile to include certain basic information about the fund

reference. See *infra* note 120 (describing and explaining the use of hyperlinks in a profile).

⁴⁷ Instruction 2 to rule 498(b). A fund must use plain English writing principles in drafting disclosure in the profile. See *supra* note 37. In response to a comment, the Commission is modifying rule 498 to clarify that information that is common to all funds or classes described in a profile need be stated only once and not repeated for each fund or class. Instruction 4 to rule 498(b). Rule 498, as adopted, does not preclude binding separate profiles for different funds together in one document.

⁴² See section 30(d) of the Investment Company Act [15 U.S.C. 80a-29(d)] and rule 30d-1 [17 CFR 270.30d-1] (requiring funds to provide investors with semi-annual reports about a fund's current operations).

⁴³ See Form N-1A Release, *supra* note 1. In proposing changes to improve the disclosure in fund prospectuses, the Commission recognized that revisions to shareholder report requirements could enhance the disclosure provided to investors. See Form N-1A Proposing Release, *supra* note 7, at 10912. Recent legislation gives the Commission greater authority to specify the content of annual reports and to require additional disclosure in annual and semi-annual reports as necessary or appropriate in the public interest or for the protection of investors. Improvements Act, *supra* note 16, section 206(f) (amending section 30 of the Investment Company Act [15 U.S.C. 80a-29] to add new paragraph (f)). The Commission notes its preliminary view that an "integrated" approach to registration and reporting requirements applicable to funds could improve the overall information about funds available to investors. See Form N-1A Release, *supra* note 1.

⁴⁴ See Profile Proposing Release, *supra* note 6, at 10945.

and to disclose that the profile is a summary disclosure document. As proposed, the cover page would identify the disclosure document as a "profile," would include a legend explaining the profile's purpose, and would include the fund's name. A fund also could describe its investment objectives or its type or category (e.g., that the fund is a growth fund or invests its assets in a particular country). Proposed rule 498 also would require the cover page to state the approximate date of the profile's first use and, if applicable, the date of the most recent updated performance information included in the profile.

The Commission is adopting the proposed cover page requirements with modifications to reflect the suggestions of various commenters.⁴⁸ Some commenters questioned the proposed requirement to state on a profile's cover page the date of the most recent performance information included in the profile, asserting that this requirement would necessitate a fund's reprinting its profile frequently to reflect updated performance information. These commenters suggested that, as an alternative, the Commission permit the date of the most recent performance information to accompany that information in the body of the profile. The Commission has concluded that the date of performance information included in a profile can be communicated to investors effectively if the date accompanies the disclosure of performance information. Rule 498, as adopted, reflects this conclusion.⁴⁹

Proposed rule 498 would require funds to identify the document on the cover page as a "profile" without using the term "prospectus."⁵⁰ Several commenters asserted that funds should be able to refer to the profile as a prospectus because a profile is a summary prospectus under the federal securities laws.⁵¹ When proposing the profile as an optional disclosure document, the Commission made it clear that the profile was not intended to supersede the section 10(a)

prospectus as the primary disclosure document for funds under the federal securities laws.⁵² In restricting funds from referring to the profile as a prospectus, the Commission intended to avoid investor confusion by distinguishing between the two documents. The Commission believes that, if a profile is labeled a prospectus, investors may not understand the difference between the two documents. In the Commission's view, the technical legal status of the profile as a summary prospectus should not be determinative of the appropriate label for the document. The Commission believes that investors will benefit from clear identification of the disclosure documents and is adopting rule 498, as proposed, with the restriction on the use of the term "prospectus."⁵³

The Commission proposed that the cover page of the profile include a legend designed to alert an investor to the summary nature of a fund's profile and to inform the investor that he or she can obtain the fund's prospectus and other disclosure materials of the fund before making a decision about investing in the fund. In considering an appropriate profile legend, the Commission sought a concise, clear statement that minimized technical or legal jargon; provided investors with a description of a fund's profile; and informed them about the availability of other information about the fund. The Profile Proposing Release set out two alternative legends about which a number of commenters expressed strong views.⁵⁴

The primary difference between the two legends proposed by the Commission was the reference to information in the prospectus. The first legend, which was similar to that used in the Pilot Profile, stated that the profile summarizes key information in the prospectus.⁵⁵ The second legend added a statement that the prospectus includes additional material information about the fund.⁵⁶

⁵² See Profile Proposing Release, *supra* note 6, at 10950. See also *supra* Section II.A.2.

⁵³ Rule 498(c)(1)(ii).

⁵⁴ See Profile Proposing Release, *supra* note 6, at 10946.

⁵⁵ See *id.* The first proposed legend read as follows:

This Profile summarizes key information about the Fund that is included in the Fund's prospectus. If you would like more information before you invest, you may obtain the Fund's prospectus and other information about the Fund at no cost by calling _____.

⁵⁶ See *id.* The second proposed legend read as follows:

This Profile summarizes key information about the Fund that is included in the Fund's prospectus. The prospectus includes additional material information about the Fund that you may want to

No commenters expressed support for the first proposed legend, and the comments on the second were mixed. Many commenters believed that the second legend would clearly inform investors that the profile contains summary disclosure of key information about a fund and that additional important information about the fund is available in the prospectus. Several of these commenters, however, strongly urged the Commission to delete the word *material* from the legend. They asserted that the use of that term would imply incorrectly that a fund's profile may be legally deficient simply because it did not contain all of the information contained in the fund's prospectus. Several commenters suggested that both of the proposed legends were insufficient and should be strengthened to alert investors more clearly about the summary nature of the profile and the availability of additional information in the prospectus.

The Commission believes that the profile legend serves an important purpose and that the numerous comments that it received on the proposed legends clearly indicate that commenters share this belief. To ensure that the legend sufficiently serves its purpose of informing investors of the summary nature of the profile, the Commission has determined to strengthen the legend and include specific language offered by commenters. As adopted, rule 498 requires the following legend on the cover page, or at the beginning, of a profile:

This profile summarizes key information about a Fund that is included in the Fund's prospectus. The Fund's prospectus includes additional information about the Fund, including a more detailed description of the risks associated with investing in the Fund that you may want to consider before you invest. You may obtain the prospectus and other information about the Fund at no cost by calling _____.⁵⁷

To ensure that fund investors who, after reviewing a profile, request other information about a fund receive that

consider before you invest. You may obtain the Fund's prospectus and other information about the Fund at no cost by calling _____.

⁵⁷ Rule 498(c)(1)(iv). A fund will be required to provide a toll-free or collect telephone number for investors to request the prospectus or other information. A fund also may, if applicable, indicate that the prospectus is available on its Internet web site or by E-mail. Rule 498(c)(1)(v). Rule 498 requires that an application to purchase shares of a fund that accompanies the fund's profile present with equal prominence the option to invest in the fund based on the information included in the profile or to request the prospectus and other information before making an investment decision. Rule 498(c)(3). See *infra* note 104 and accompanying text.

⁴⁸ One commenter requested clarification whether a profile must include a separate cover page. Rule 498, as adopted, clarifies that a profile need not have a separate cover page so long as the specified cover page disclosure is included as introductory information at the beginning of the profile. The proposed cover page requirements were intended to identify introductory information that should appear at the beginning of a profile.

⁴⁹ Rule 498(c)(2)(iii). Rule 498 permits a fund to reflect updated performance information in a "sticker" or similar means to avoid requiring frequent reprinting of the profile to change this section of the profile. Instruction to rule 498(c)(2)(iii).

⁵⁰ Proposed rule 498(c)(1)(ii).

⁵¹ See *supra* note 16.

information promptly, the Commission proposed to require a fund to send its prospectus to the requesting investors within 3 business days of a request. Those commenters addressing this requirement generally supported it, although one commenter maintained that revising the requirement to state that mailings need to be made "reasonably promptly," which the commenter stated should normally be deemed to be within 3 business days of a request, would protect funds against claims that they failed to meet the requirements as a result of unforeseen circumstances. The Commission continues to believe, as discussed in the Profile Proposing Release, that prompt mailing of the prospectus to investors who request it is an essential component of the profile initiative and the goal of promoting effective communication of information about funds.⁵⁸ Therefore, the Commission is adopting the 3-business day mailing requirement as proposed.⁵⁹

Some commenters requested clarification from the Commission about the procedure that a fund should follow in responding to requests for additional information when its shares are sold through financial intermediaries, such as broker-dealers or banks. Commenters recommended that the Commission revise rule 498 to permit the legend to state that additional information in such a case may be obtained from financial intermediaries. The Commission acknowledges that many funds use intermediaries in distributing or servicing their shares and that investors may look to these intermediaries for information about the funds. Thus, rule 498, as adopted, allows funds to state that additional information about a fund is available from a financial intermediary.⁶⁰ A fund whose information is available through another entity, however, retains the obligation to ensure that information is sent to investors within 3 business days of an investor's request. The Commission

expects that funds will fulfill this obligation through contractual arrangements with broker-dealers, banks, or other financial intermediaries.

2. Risk/Return Summary

The Commission proposed that the first 4 items of the profile elicit information that would be substantially identical to the proposed risk/return summary at the beginning of every prospectus. Most commenters supported the risk/return summary in the profile, and the Commission is adopting it generally as proposed. The Form N-1A Release discusses in detail the prospectus risk/return summary.⁶¹ The risk/return summary required in the profile by rule 498, as adopted, will incorporate substantially all of the requirements for the summary in Form N-1A, as amended. The following discussion summarizes the main features of the risk/return summary required by Form N-1A and discusses specific disclosure required in the profile.

—Fund Investment Objectives/Goals

To assist investors in identifying funds that meet their general investment needs, the proposed risk/return summary would require a fund to disclose its investment objectives or goals. The Commission is adopting this disclosure requirement in rule 498 as proposed.⁶²

—Principal Investment Strategies

The proposed risk/return summary would require a fund to summarize, based on the information provided in its prospectus, how the fund intends to achieve its investment objectives. The purpose of the proposed disclosure was to provide a summary of the fund's principal investment strategies, including the specific types of securities in which the fund invests or will invest principally, and any policy of the fund to concentrate its investments in an industry or group of industries. The Commission is adopting this requirement in rule 498 as proposed.⁶³

In seeking to supplement the information about a fund's principal investment strategies set out in a profile, the Commission proposed to require that a fund's risk summary inform investors about the availability in the fund's shareholder reports of additional information about the fund's investments.⁶⁴ Some commenters

questioned the proposed placement of this disclosure, arguing that the disclosure should appear together with the legend on the cover page of the profile, while other commenters supported requiring the disclosure in the profile's risk/return summary. The Commission believes that requiring this disclosure on the cover page of the profile would result in too much information on the cover page. Therefore, the Commission is adopting the proposal requiring a fund's profile to indicate in its risk summary that additional information about a fund's investments is available in its shareholder reports.⁶⁵

—Principal Risks of Investing in the Fund

Summary Risk Disclosure. The proposed risk/return summary would require a fund to summarize the information contained in the fund's prospectus about the principal risks of investing in the fund. Reflecting the Commission's proposed new approach to risk disclosure described in the Form N-1A Proposing Release, the profile disclosure was intended to summarize the risks of a fund's anticipated portfolio holdings as a whole, and the circumstances reasonably likely to affect adversely the fund's net asset value, yield, and total return.⁶⁶ Commenters generally supported the summary risk disclosure contemplated by proposed rule 498, agreeing that it would be focused and brief and would assist investors in identifying the principal risks of investing in a particular fund. The Commission is adopting this disclosure requirement with modifications to reflect certain commenters' suggestions.⁶⁷

The Commission proposed to require that the risk summary identify the types

during its most recent fiscal year, could be useful to some investors considering an investment in the fund.

⁶⁵ Rule 498(c)(2)(ii). This provision requires a fund (other than a new fund) to include disclosure in the risk/return summary to the following effect:

Additional information about the fund's investments is available in the fund's annual and semi-annual reports to shareholders. In the fund's annual report you will find a discussion of the market conditions and investment strategies that significantly affected the fund's performance during the last fiscal year. You may obtain either or both of these reports at no cost by calling _____.

Unlike rule 498, as adopted, Form N-1A, as amended, requires that the statement about the availability of a fund's shareholder reports appear together with disclosure about the availability of the fund's SAI and other information about the fund on the back cover page of the fund's prospectus. Item 1(b)(1) of Form N-1A.

⁶⁶ See Form N-1A Proposing Release, *supra* note 7 (regarding fund risk disclosure required in the prospectus).

⁶⁷ Rule 498(c)(2)(iii) (incorporating Item 2(c)(1)(i) of Form N-1A).

⁵⁸ See Profile Proposing Release, *supra* note 6, at 10946.

⁵⁹ Instruction to rule 498(c)(1)(v). The Commission's Office of Compliance Inspections and Examinations will, as a part of its routine periodic inspections of a fund's operations, examine a fund's compliance with the 3-business day mailing requirement. In addition to the 3-business day mailing requirement for prospectuses, rule 498 requires a fund to send within 3 business days of a request its annual or semi-annual shareholder report and Statement of Additional Information ("SAI"). *Id.* The Commission staff also will examine a fund's compliance with this requirement. Failure to comply with either requirement could result in action by the Commission to ensure compliance, including an enforcement action in an appropriate case.

⁶⁰ Instruction to Rule 498(c)(1)(v).

⁶¹ See Form N-1A Release, *supra* note 1.

⁶² Rule 498(c)(2)(i).

⁶³ Rule 498(c)(2)(ii).

⁶⁴ A fund's annual report to its shareholders typically contains a MDPF. The Commission believes that the information in a fund's MDPF, including the discussion of the fund's performance

of investors for whom the fund may be an appropriate or inappropriate investment. Commenters either opposed or raised significant concerns about this provision, arguing that it could be viewed as requiring a fund to determine whether its shares, among other things, are an investment suitable for a particular investor.⁶⁸ Commenters also stated that the disclosure would tend to be generic and not meaningful or useful for investors.

The Commission is persuaded by commenters that disclosure about the appropriateness of funds for particular investors should not be required in all profiles and has deleted this requirement from the risk summary. The Commission believes, however, that disclosure indicating whether a fund is appropriate for specific types of investors or is consistent with certain investment goals, even if generic in nature, may be useful for some investors and may provide a means for the fund to distinguish itself from other investment alternatives. Therefore, the risk summary requirement, as adopted, will give a fund the option to include disclosure in its profile about the types of investors for whom the fund is intended and the types of investment goals that may be consistent with an investment in the fund.⁶⁹

Under the proposed risk/return summary, a fund could at its option discuss the potential rewards of investing in the fund in the risk summary as long as the discussion provided a balanced presentation of the fund's risks and rewards. One commenter strongly questioned this provision of the proposal, asserting that it would detract from a clear presentation of risks in the summary. The Commission has reconsidered this disclosure in light of the intended standardized and summary nature of the risk summary and has concluded that the disclosure there should focus solely on the risks of investing in the fund. Thus, the Commission has determined to eliminate the option to describe the rewards of investing in a fund in the risk summary.⁷⁰

⁶⁸ As several commenters pointed out, applicable regulatory rules for brokers and other investment professionals require that these determinations be made on the basis of a review of information about the unique circumstances of an individual investor. See, e.g., rule 2310(a) of the National Association of Securities Dealers, Inc. ("NASD") Conduct Rules, NASD Manual (CCH) ¶4261 (suitability of recommendations); rule 405 of the New York Stock Exchange, 2 N.Y.S.E. Guide (CCH) ¶2403 (the "know your customer rule").

⁶⁹ Rule 498(c)(2)(iii) (incorporating Item 2(c)(1)(i) of Form N-1A).

⁷⁰ In keeping with the disclosure flexibility provided to funds under Form N-1A, as amended,

Special Risk Disclosure Requirements. The Commission proposed to require special disclosure in the risk summary for money market funds⁷¹ and for funds advised by or sold through banks. Commenters supported the proposed disclosure requirements, and the Commission is adopting them substantially as proposed.⁷²

The Commission proposed to require a tax-exempt money market fund that concentrates its investments in a particular state (a "single state money market fund") to include specific disclosure in its profile risk summary describing certain risks associated with an investment in such a fund.⁷³ In the

a fund could discuss the potential rewards of investing in the fund elsewhere in its prospectus as long as the information is not incomplete, inaccurate, or misleading. See Form N-1A Release, *supra* note 1.

⁷¹ For these purposes, a money market fund is a fund that holds itself out to investors as a money market fund and meets the conditions of paragraphs (c)(2), (c)(3), and (c)(4) of rule 2a-7 under the Investment Company Act [17 CFR 270.2a-7].

⁷² Rule 498(c)(2)(iii) (incorporating Item 2(c)(1)(ii) of Form N-1A). This provision, as adopted, requires the following disclosure by a money market fund in the risk summary of its profile:

An investment in the Fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although the Fund seeks to preserve the value of your investment at \$1.00 per share, it is possible to lose money by investing in the Fund.

A fund advised by or sold through a bank would disclose in the risk summary of its profile:

An investment in the Fund is not a deposit of the bank and is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency.

Some commenters asserted that the proposed disclosure was inconsistent with that required by bank regulators in the Interagency Statement on Retail Sales of Nondeposit Investment Products. See Board of Governors of the Federal Reserve System, FDIC, Office of the Comptroller of the Currency, and Office of Thrift Supervision, Interagency Statement on Retail Sales of Nondeposit Products, 6 Fed. Banking L. Rep. (CCH) ¶70-113, at 82,598 (Feb. 15, 1994) ("Interagency Statement") (requiring disclosure that the fund is not a deposit or other obligation of the bank). The Commission has confirmed with these bank regulators that no such inconsistency exists, because the disclosure required by the Interagency Statement applies to sales material and not to fund prospectuses. In response to suggestions from bank regulators, the Commission has revised the required disclosure to add language indicating that an investment in a fund advised by or sold through a bank is not a deposit of the bank. The requirement, as amended in this way, is consistent with the requirement now in effect.

The Commission is making conforming amendments to the disclosure requirement contained in rule 482(a)(7) for advertisements by money market funds. The Commission also is amending rule 482(d) under the Securities Act and rule 34b-1 under the Investment Company Act [17 CFR 270.34b-1] to conform to changes made in Item 21 of Form N-1A, as amended. See Form N-1A Release, *supra* note 1.

⁷³ Proposed rule 498 would require a single state money market fund to make disclosure similar to that Form N-1A currently requires such a fund to disclose in its prospectus. Existing Form N-1A

Form N-1A Proposing Release, the Commission asked, however, whether it should continue to require this disclosure in prospectuses.⁷⁴ The Commission noted that this disclosure may exaggerate the risk of investing in single state money market funds. As the Form N-1A Proposing Release pointed out, although these funds are subject to less stringent issuer diversification provisions under Commission rules than other money market funds, they are subject to credit quality and maturity investment restrictions that are comparable to other money market funds.

In response to the Commission's question regarding single state money market funds, commenters indicated that the special disclosure now required in fund prospectuses overstates the risks of investing in single state money market funds, particularly in view of the minimal risk that commenters asserted is associated with these funds. The Commission is persuaded by these commenters and has determined not to require the disclosure in either the profile or the prospectus.⁷⁵

Risk/Return Bar Chart and Table. The proposed risk/return summary would require a fund's profile to include a bar chart showing the fund's annual returns for each of the last 10 calendar years and a table comparing the fund's average annual returns for the last 1-, 5-, and 10-fiscal years to those of a broad-based securities market index. The bar chart reflects the Commission's determination that investors need improved disclosure about the risks of investing in a fund. The bar chart is intended to illustrate graphically the variability of a fund's returns (e.g., whether a fund's annual returns for a 10-year period have varied significantly from year to year or were relatively even over the period). Presenting return information in this format was designed to give investors some indication of the variability of a fund's annual returns and thus some idea of the risk of an investment in the fund. The average annual return information in the table would assist investors in evaluating a fund's performance and risks relative to "the market." Commenters generally supported the proposed bar chart and performance table, and the Commission is adopting these requirements with

requires a single state money market fund to disclose that it may invest a significant percentage of its assets in a single issuer and that investing in it may be riskier than investing in other types of money market funds. See Form N-1A Proposing Release, *supra* note 7, at 10903.

⁷⁴ See Form N-1A Proposing Release, *supra* note 7, at 10904.

⁷⁵ See Form N-1A Release, *supra* note 1.

modifications to reflect suggestions of commenters.⁷⁶

In the Form N-1A Proposing Release, the Commission requested comment about alternative presentations that could improve fund risk disclosure.⁷⁷ In particular, the Commission expressed interest in disclosure that would show a fund's highest and lowest returns (or "range" of returns) for annual or other periods as an alternative, or in addition, to the bar chart. The Commission suggested that this information could be presented in a separate table or included in the performance table.

In response to the Commission's request, some commenters suggested including in a fund's bar chart one or more indexes or other benchmarks (such as 3-month Treasury returns or the rate of inflation) to help investors evaluate the fund's returns by comparisons to other measures of market performance or economic factors.⁷⁸ Most commenters, however, opposed requiring additional information in the bar chart, asserting that it could complicate and reduce the effectiveness of the bar chart.

Several commenters supported the inclusion of annual return information in the bar chart on a quarterly or semi-annual rather than an annual basis. They argued that this change to the bar chart would respond to concerns that fund investors may not sufficiently appreciate that an investment in a fund may be subject to the risk of a short-term decline in value. This risk, commenters asserted, may not be apparent from the annual returns proposed to be shown in the bar chart.

The Commission acknowledges that a fund's returns may vary significantly and could decrease in value over short

periods and that the annual returns in the bar chart, as proposed, would not necessarily reflect this pattern. On the other hand, the Commission is concerned that requiring quarterly returns over a 10-year period would make the bar chart more complex and less useful in communicating information to investors. In balancing the desire to make typical fund investors aware that fund shares may experience price fluctuations over shorter periods with its underlying goal that fund documents communicate information in as straightforward and uncomplicated a manner as possible, the Commission has determined to require a fund to disclose, in addition to the bar chart, its best and worst returns for a quarter during the 10-year (or other) period reflected in the bar chart.⁷⁹ The Commission believes that this information will assist investors in understanding the variability of a fund's returns and the risks of investing in the fund by illustrating, without adding unwarranted complexity to the bar chart, that the fund's shares may be subject to short-term price fluctuations.

Presentation of Return Information. The proposed risk/return summary would require a fund to include the bar chart and table under a separate sub-heading that referred to both risk and performance. Several commenters argued that the separate sub-heading requirement was unnecessary and suggested that a fund should be able to choose whether to include any sub-heading. Consistent with the objective of encouraging funds to develop disclosure formats that are most helpful to investors, the profile risk/return summary, as adopted, does not require the sub-heading including the proposed risk/return summary. To help investors use the information in the bar chart and table, the profile risk/return summary, as adopted, however, does require a fund to provide a brief narrative explanation of how the information illustrates the variability of the fund's returns.⁸⁰

Bar Chart Return Information. The Commission proposed to require that a fund's bar chart show the fund's annual returns for the last 10-calendar years of the fund's existence. The purpose of the calendar-year requirement was to facilitate the comparison of the annual returns among funds, which typically have fiscal periods that do not correspond to the calendar year.⁸¹

Unlike the proposed bar chart, the proposed performance table required disclosure of a fund's returns for fiscal year periods. In requiring this disclosure to be made for fiscal year periods, the proposal was consistent with existing disclosure requirements for the presentation of other financial information included in a fund's prospectus.

Several commenters argued that using different time periods for the proposed bar chart and performance table would confuse investors and urged the Commission to minimize potential investor confusion by adopting consistent time periods for this information. The Commission is persuaded by these comments and believes that requiring both the bar chart and the performance table to be based on calendar periods will promote understandable information in the profile. Therefore, the risk/return summary, as adopted, requires calendar-year periods for both the bar chart and table.⁸² Under rule 498, as adopted, the average annual return information in the table in a fund's profile risk/return summary must be as of the most recent calendar quarter and updated quarterly.⁸³

The proposed bar chart would not reflect sales loads assessed upon the sale of a fund's shares, although the average annual return information for the fund in the table would reflect the payment of any sales loads. Commenters generally supported this presentation of annual return information. The Commission believes that, in light of the different types of sales loads that may be charged on fund shares, it would be difficult for funds to compute annual returns for the purpose of the bar chart and to communicate the information effectively to investors.⁸⁴ In addition, the Commission has concluded that more precise return information is not necessary for the bar chart to serve the purposes of graphically showing a fund's annual returns and illustrating

companies and tend to stagger the financial periods of their series to spread audits and financial reporting periods over an entire calendar year.

⁸² Rule 498(c)(2)(iii) (incorporating Item 2(c)(2) of Form N-1A).

⁸³ Rule 498(c)(2)(iii). Unlike rule 498, as adopted, Form N-1A, as amended, requires the fund's prospectus risk/return summary to reflect average annual return information as of the end of a fund's most recent calendar year. Item 2(c)(2) of Form N-1A, as amended. A fund would update the information in the prospectus in connection with the filing of an annual post-effective amendment to update a fund's registration statement.

⁸⁴ In contrast, sales loads can be accurately and fairly reflected in return information of the type contained in the table by deducting sales loads at the beginning (or end) of particular periods from a hypothetical initial fund investment.

⁷⁶ Rule 498(c)(2)(iii) (incorporating Item 2(c)(2) of Form N-1A). This provision requires a fund to have at least one calendar year of returns before including the bar chart and requires a fund whose profile does not include a bar chart because the fund does not have annual returns for a full calendar year to modify the narrative explanation to refer only to information presented in the table. The provision also requires the bar chart of a fund in operation for fewer than 10 years to include annual returns for the life of the fund.

In adopting the bar chart requirement, the Commission does not mean to suggest that all, or even a significant portion of all fund investors equate the variation in a fund's returns to the risk of investing in the fund. As it indicated in the Form N-1A Release, the Commission acknowledges that investors have a wide range of ideas of what "risk" means. See Form N-1A Release, *supra* note 1.

⁷⁷ See Form N-1A Proposing Release, *supra* note 7, at 10907.

⁷⁸ Rule 498, as adopted, in incorporating the requirements of Form N-1A, as amended, permits a fund to use other indexes in the presentation of the average annual return information in the table accompanying the bar chart. Rule 498(c)(2)(iii) (incorporating Instruction 2(b) to Item 2(c)(2) of Form N-1A).

⁷⁹ Rule 498(c)(2)(iii) (incorporating Item 2(c)(2)(ii) of Form N-1A).

⁸⁰ Rule 498(c)(2)(iii) (incorporating Item 2(c)(2)(i) of Form N-1A).

⁸¹ The Commission understands that funds increasingly organize themselves as series

the variability of an investment in the fund over a 10-year period. Therefore, the bar chart, as adopted, is not required to show returns adjusted for sales loads.

Bar Chart Presentation. Consistent with the bar chart as proposed, the bar chart, as adopted, may include return information for more than one fund.⁸⁵ In contrast, the risk/return summary, as adopted, would require a fund offering more than one class of shares in a profile to include annual return information in its bar chart for only one class.⁸⁶ Unlike individual funds, classes of funds represent interests in the same portfolio of securities and the returns of each class differ only to the extent that the classes do not have the same expenses. The Commission believes that including return information for all classes offered through a fund's profile is not necessary to provide an indication of the risks of investing in the fund. In addition, the table accompanying such a fund's bar chart would provide return information for each class offered in the profile so that investors will be able to identify and compare the performance of each class.⁸⁷

The proposed risk/return summary would require the bar chart of a fund offering more than one class of shares through a profile to reflect annual return information for the class offered in the profile that had the longest performance history over the last 10 years. Most commenters considering the issue suggested that the Commission instead permit such a fund to include the performance of any existing class in the bar chart, maintaining that the effect of expenses on the returns for different classes of shares is not significant.⁸⁸ The Commission is persuaded that allowing a multiple class fund in such a case to choose the class reflected in the fund's bar chart will simplify compliance with the bar chart requirement and provide investors with sufficient information to evaluate the variability of returns for any class of the fund. Therefore, the

profile risk/return summary, as adopted, permits a fund to choose the class to be reflected in the bar chart, subject to certain limitations.⁸⁹

—Fees and Expenses of the Fund

The proposed risk/return summary would require a table accompanying a fund's bar chart showing the fund's fees and expenses, including any sales loads charged in connection with an investment in the fund. Including the fee table in both the profile and the prospectus reflects the Commission's strongly held belief in the importance of fees and expenses in a typical investor's decision to invest in a fund. The fee table is designed to help investors understand the costs of investing in a fund and to compare those costs with the costs of other funds. The Commission is adopting the requirement for a fee table with modifications incorporating suggestions from commenters.⁹⁰

3. Other Disclosure Requirements

The Commission proposed to require the profile of a fund to include not only the risk/return summary, but also disclosure about other key aspects of investing in the fund. Commenters generally supported these disclosure requirements, which are summarized below, and the Commission is adopting them substantially as proposed.

—Investment Adviser and Portfolio Manager of the Fund

Proposed rule 498 would generally require a fund to identify in its profile its investment adviser and the person or persons primarily responsible for the day-to-day management of the fund's portfolio ("portfolio manager"). The proposed disclosure in the profile about portfolio managers also would require a fund to indicate the length of time that a portfolio manager has managed the fund and to summarize the portfolio manager's business experience for the last 5 years. Proposed rule 498 contemplated that a fund for which a committee or other group shared day-to-day management of its portfolio would disclose that it was managed in this fashion and not identify any individual portfolio manager. Commenters

supported all of these proposed requirements, which the Commission has determined to adopt.⁹¹

In seeking to meet its goal that profile disclosure be clear, concise, and summary in nature, the Commission proposed that, subject to one exception, a fund having 3 or more portfolio managers, each with responsibility over a portion of the fund's portfolio, could choose to disclose the number, and not the names, of its portfolio managers. Under the proposed exception, a fund would be required to disclose the identity of a portfolio manager who was responsible for managing 40% or more of its portfolio.⁹² One commenter questioned the operation of these provisions and suggested that the Commission instead adopt a requirement that a fund disclose the name and experience of only those portfolio managers having responsibility over the day-to-day management of a significant portion of the fund's investments. The commenter suggested further that 30 to 40% of a fund's portfolio should be deemed significant for this purpose.

The Commission believes that the commenter's suggestions are consistent with the goal underlying the profile and could result in better disclosure than that contemplated by the Commission's proposal. Thus, under rule 498, as adopted, a fund with 3 or more portfolio managers need not identify each of the managers, except that the fund must identify any manager who is (or is reasonably expected to be) responsible for the management of a significant portion of the fund's assets.⁹³ Under rule 498, as adopted, a portfolio manager of 30% or more of a fund's net assets generally would be deemed to be responsible for the management of a

⁸⁵ While rule 498 does not limit the number of funds whose return information may be included in a bar chart, the presentation of the bar chart is subject to the general requirement that disclosure should be presented in a format designed to communicate information effectively. Instruction 2 to rule 498(b).

⁸⁶ Rule 498(c)(2)(iii) (incorporating Instruction 3(a) to Item 2(c)(2) of form N-1A).

⁸⁷ Rule 498(c)(2)(iii) (incorporating Instruction 3(b) to Item 2(c)(2) of form N-1A).

⁸⁸ In making this argument, commenters cited rule 18f-3 under the Investment Company Act [17 CFR 270.18f-3], which provides that a class of shares may have different expenses for shareholder services, distribution fees, or other expenses actually incurred in a different amount by the class. The rule does not permit expenses for advisory or custodial fees, or other management fees, to vary among classes.

⁸⁹ Rule 498(c)(2)(iii) (incorporating Instruction 3(a) to Item 2(c)(2) of Form N-1A). The bar chart must reflect the performance of any class that has returns for at least 10 years (e.g., a fund could not present a class in the bar chart with 2 years of returns when another class has returns for at least 10 years). In addition, if two or more classes offered in the profile have returns for less than 10 years, the bar chart must reflect returns for the class that has returns for the longest period.

⁹⁰ Rule 498(c)(2)(iv) (incorporating Item 3 of Form N-A). The modifications adopted by the Commission are discussed in Form N-1A Release, *supra* note 1.

⁹¹ Rule 498(c)(2)(v). Item 6(a)(2) of Form N-1A sets out the disclosure requirements for Form N-1A covering this information. As discussed in the Form N-1A Release, the Commission has provided additional guidance in Form N-1A regarding the prospectus disclosure obligations of a fund for which day-to-day management responsibilities are shared. See Form N-1A Release, *supra* note 1 (Instructions to Item 6(a)(2)).

⁹² Under the 1996 Profile Letter, *supra* note 8, at 3, a fund could disclose that 3 or more persons managed the fund's portfolio, without regard to the percentage of the portfolio managed by any one person.

⁹³ Rule 498(c)(2)(v)(C). In tying this disclosure to the portion of a fund's net assets over which a person has day-to-day responsibility, the Commission intends to provide funds with a standard way of determining whether a person has responsibility over a significant portion of a fund's portfolio. Like Form N-1A, as amended, rule 498, as adopted, does not require disclosure about the portfolio manager of a money market fund or an index fund.

significant portion of the fund's net assets.⁹⁴

Proposed rule 498 generally would require a fund to identify in its profile any person or entity serving as a sub-adviser of the fund.⁹⁵ Under the proposal, a fund would not need to identify a sub-adviser whose sole responsibility for the fund is limited to managing the fund's cash positions on a day-to-day basis.⁹⁶ Commenters supported, and the Commission has adopted, this provision, with a clarification that recognizes that responsibility for cash management generally is incidental to a fund's investment objectives and unlikely to affect the fund's overall portfolio management and risks.⁹⁷

Under rule 498, as proposed, a fund with 3 or more sub-advisers, each of which manages a portion of the fund's portfolio, could choose to disclose the number, and not the identity, of its sub-advisers, subject to one exception. Under the exception, a fund would be required to identify any sub-adviser that manages 40% or more of its net assets. Consistent with the modification to the disclosure requirement for portfolio managers, rule 498, as adopted, requires a fund to identify any sub-adviser that is (or is reasonably expected to be) responsible for the management of a significant portion of the fund's net assets. The rule defines a significant portion of the fund's net assets for this purpose generally to be 30% or more of the fund's net assets.⁹⁸

—Purchase and Sale of Fund Shares

The Commission proposed to require a fund to describe in its profile how to purchase its shares under one caption

and how to redeem its shares under another caption. Proposed rule 498 would require, under the purchase caption, information about the fund's minimum investment requirements (e.g., initial and minimum account balances) and, when applicable, any breakpoints in or waivers of sales loads.

Several commenters criticized the generic nature of the information on purchases and sales of fund shares contemplated by proposed rule 498. They argued that without some guidance as to the specific kinds of information relating to purchases and sales of fund shares that the Commission believes is of importance to investors, funds would include an excessive amount of information in their profiles. The Commission believes that such a result would be inconsistent with the profile's intended purpose as a summary disclosure document and has revised rule 498 to specify in greater detail the information about a fund's purchase and sale procedures that funds must include in a profile. Under rule 498, as adopted, a fund must disclose the minimum initial or subsequent investment requirements, the initial sales load (or other loads), and, if applicable, the initial sales load breakpoints or waivers.⁹⁹ Rule 498 also requires a fund to state that its shares are redeemable, to identify the procedures for redeeming shares (e.g., on any business day by written request, telephone, or wire transfer), and to identify any charges or sales loads that may be assessed upon redemption (including, if applicable, the existence of waivers of these charges).¹⁰⁰

—Fund Distributions and Tax Information

The Commission is adopting the proposed requirement that a fund disclose information in its profile about the terms and conditions under which it makes distributions, as well as the expected tax treatment of those distributions.¹⁰¹ Rule 498, as adopted, requires a fund's profile to describe how frequently the fund intends to make distributions and what reinvestment options for distributions (if any) are available to investors in the fund. Rule 498 also requires a fund to disclose whether its distributions to shareholders may be taxed as ordinary income or capital gains and that the rates shareholders pay on capital gains will depend on the length of time that the fund holds its assets.¹⁰² Rule 498

requires a tax-exempt fund to state that it intends to distribute tax-exempt income and to disclose, as applicable, that a portion of its distributions may be taxable.

—Other Services Provided by the Fund

Recognizing that funds often seek to distinguish themselves by the services that they offer investors and that investors often select funds for the services that they provide, the Commission proposed to require a fund to summarize or list in its profile the services available to its investors, including, for example, any exchange privileges or automated information services. One commenter expressed concern about the open-ended nature of this item and suggested that the Commission clarify that a fund need not respond to the item by disclosing all of its services available to all investors. This clarification, according to the commenter, would ensure that the profile serves its intended purpose as a summary document that includes information of use to a typical fund investor. The Commission agrees, and as adopted, rule 498 requires only that a fund's profile provide a summary of services available to typical investors in the fund.¹⁰³

4. Application to Purchase Shares

The Commission proposed to permit a fund to include in its profile an application to purchase its shares.¹⁰⁴ To ensure that investors are informed of the

primarily will consist of ordinary income or capital gains, the fund must provide disclosure to that effect in responding to rule 498(c)(2)(viii). Funds subject to this requirement would include, for example, those often described as "tax-managed," "tax-sensitive," or "tax-advantaged," which have investment strategies to maximize long-term capital gains and minimize ordinary income. To the extent that a fund has a principal investment objective or strategy to achieve tax-managed results (e.g., to maximize long-term gains and minimize ordinary income), the fund would be required under rule 498 to provide disclosure to that effect in the discussion of its investment objectives. Rule 498(c)(2)(ii).

¹⁰³ Rule 498(c)(2)(ix).

¹⁰⁴ Proposed rule 498(c)(3). Rule 482 under the Securities Act prohibits a fund from including an application to purchase its shares in an advertisement. This prohibition was based on concerns that an application would be inconsistent with the purpose of rule 482, which was to provide a limited amount of information about a fund and a means of requesting a fund's prospectus. See Fund Performance Release, *supra*, note 5. In 1993, the Commission proposed to amend rule 482 to permit a fund to include in an advertisement a purchase application if the advertisement included certain information about a fund. Investment Company Act Release No. 19342 (Mar. 5, 1993) [58 FR 16141]. In lieu of adopting the proposed revisions to rule 482, the Commission is adopting rule 498. The Commission is amending rule 482 in a number of respects to reflect the adoption of rule 498. In addition, the Commission is adopting revisions to rule 482 to permit letters or other materials permitted under the rule to accompany a profile. See *infra* note 123 and accompanying text.

⁹⁴ Rule 498, as adopted, requires disclosure about a portfolio manager of a fund who is, or who is reasonably expected to be, responsible for the management rather than one who "manages" a significant portion of the fund's portfolio. The revised language recognizes that the portion of a fund's portfolio over which a manager has responsibility may change from time to time.

⁹⁵ See section 2(a)(20) of the Investment Company Act [15 U.S.C. 80a-2(a)(20)] (defining "investment adviser" broadly so as to include a sub-adviser).

⁹⁶ In contrast the 1996 Profile Letter, *supra* note 8, at 3, required disclosure about a sub-adviser only if it managed a material portion of a fund's portfolio.

⁹⁷ Rule 498(c)(2)(v). As adopted, this exception does not apply to any sub-adviser for a money market fund because the primary investment objective for such a fund can be viewed as cash management. The exception also does not apply to any other type of fund with a principal strategy of regularly holding cash or cash equivalent instruments. A fund, for example, with a principal strategy of allocating its assets among cash equivalents, equity securities, and income securities, and which employed different sub-advisers to manage each of these asset categories, would need to identify all of the sub-advisers.

⁹⁸ Rule 498(c)(2)(v)(B)(2).

⁹⁹ Rule 498(c)(2)(vi).

¹⁰⁰ Rule 498(c)(2)(vii).

¹⁰¹ Rule 498(c)(2)(viii).

¹⁰² If a fund expects that its distributions, as a result of its investment objectives or strategies,

availability of a fund's prospectus, which can be reviewed by an investor before investing in the fund, proposed rule 498 would require the application to note with equal prominence that an investor has the option of purchasing shares of the fund after reviewing the information in the profile or after requesting and reviewing the fund's prospectus (and other information).

Commenters generally supported permitting a fund to include an application in its profile, and the Commission is adopting rule 498 as proposed. One commenter questioned why an application needed to be included within a profile and suggested that it should be sufficient for an application to accompany the profile. The Commission recognizes that allowing funds to separate purchase applications from profiles may facilitate the printing and distribution of profiles and make it easier for funds to administer and process investors' applications. The Commission is concerned, however, that separating the application from the profile may cause investors to overlook the information provided in the profile. Balancing these concerns with a desire to ease the administrative burden on funds, the Commission has revised rule 498 to permit a fund to provide an application for purchase of fund shares either in the profile, or together with the profile in a manner reasonably designed to alert investors that the application is to be considered along with the information about the fund disclosed in the profile.¹⁰⁵

C. Filing Requirements

The Commission proposed to require a fund to file its profile with the Commission at least 30 days before its first use.¹⁰⁶ Proposed rule 498 would require a fund to file any profile containing substantive changes to a previously filed profile 30 days before use. The proposed rule would not require a fund to re-file a previously filed profile that has been revised only to update return information about the fund's past performance included in the risk/return summary. Commenters generally supported the proposed filing requirement, although some commenters suggested that it was unnecessary to require the subsequent re-filing of a profile with substantive changes 30 days before use. Commenters recommended that, if the

Commission believes that such a filing requirement is necessary, the period before an amended profile can be used should be shortened to 5 days. Other commenters requested clarification about the kinds of changes made to a profile in use that would trigger a second filing requirement.

The Commission has determined to adopt the proposed filing requirements with modifications to address commenters' concerns.¹⁰⁷ As discussed in the Profile Proposing Release, requiring profiles to be filed prior to their first use will allow the Commission's staff to monitor the document's compliance with the provisions of rule 498 and other provisions under the federal securities laws.¹⁰⁸ The Commission believes that the 30-day filing requirement for a new profile will provide the staff with sufficient time to review the profile.¹⁰⁹ The subsequent filing of an amended profile was intended to enable the Commission to continue to monitor and assess the use of profiles by funds. Because substantive changes to the profile, particularly the risk/return summary, will be reflected in amended prospectus filed with the Commission that can be reviewed by the Division, the Commission believes that a subsequent filing of amendments to a profile before its use is not necessary. Therefore, the Commission has revised the procedures under which profiles are filed to require that a fund file its amended profile within 5-business days after its use.¹¹⁰

Funds would be required to submit profiles electronically on the

¹⁰⁷ The Commission has determined that it is not necessary or appropriate in the public interest or for the protection of investors to require that a fund's profile be filed as part of the fund's registration statement on Form N-1A. Filing the profile as part of a registration statement would not add to the Commission's ability to monitor the disclosure in the profile, would provide no additional protection to investors, and would impose unnecessary administrative burdens on funds.

¹⁰⁸ See Profile Proposing Release, *supra* note 6, at 10950. Under rule 498, as adopted, a profile can be used by a fund only with an effective registration statement and a current prospectus.

¹⁰⁹ Rule 497, as amended, requires a fund to file a definitive form of any profile required to be filed with the Commission within 5 days after it is used.

¹¹⁰ Rule 497(k)(1)(ii). Rule 497(k) separates filings of amended profiles into those that contain a material change to the investment objectives/goals, strategies, or risks of investing in the fund (changes to the information in, respectively, paragraphs (c)(2)(i)-(iii) of rule 498) and those that do not. Rule 497(k)(1)(iii) (A) and (B). As with any profile filing, rule 497 requires that a fund filing an amended profile designate under which paragraph and subparagraph of rule 497 the fund is filing the amended profile. Rule 497(k)(2)(i). This requirement will assist the staff of the Division in determining whether an amended profile contains substantive changes to the information in the risk/return summary.

Commission's electronic data gathering analysis and retrieval ("EDGAR") system.¹¹¹ Because filings on the EDGAR system currently are text-only, do not reflect formatting, and do not reproduce graphic images (such as the bar chart required to be in the profile), the Commission proposed to require a fund to submit 2 copies of the profile in the primary form intended to be distributed to investors (e.g., paper or electronic media) with its electronically-filed profile. The purpose of this requirement was to allow the Commission to assess how funds present information in the profile.¹¹² Pointing out that all funds are now required to file their disclosure documents required under the federal securities laws electronically and are no longer permitted to file paper copies, one commenter argued that it would be burdensome to require an additional paper submission of a profile and that the paper filing was not necessary to review the content of the profile. The commenter suggested that, if the Commission determines that a paper (or other distributed form of) filing is necessary, the Commission should require that the first filing of the profile be in its primary format and allow subsequent filings to be made electronically on EDGAR only. The Commission believes that review of profiles in the form in which they will be distributed to investors will allow its staff to evaluate the effectiveness of the profile and will be helpful in assessing whether the Commission should permit other types of investment companies to use a form of profile.¹¹³ To avoid unnecessary administrative burdens on funds, which file most forms required by the Commission electronically, however, the Commission is revising the additional profile filing requirement. Under these revisions, the first profile filing must be accompanied by the submission of a profile in the format in which it will be distributed to investors.¹¹⁴ Subsequent filings will not require the additional formatted profile.

D. Dissemination of Profiles

The Commission believes, on the basis of its own research and studies

¹¹¹ The Commission requires most other filings to be made in the same manner. Rule 101(a)(1)(i) of Regulation S-T [17 CFR 232.101(a)(1)(i)], for example requires prospectuses filed pursuant to the Securities Act to be submitted in electronic format.

¹¹² See Profile Proposing Release, *supra* note 6, at 10951 nn. 86-88 and accompanying text.

¹¹³ See *supra* Section II.A.4 (discussion of use of profile by other investment companies).

¹¹⁴ Rule 497(k)(2)(ii). If a fund intends to disseminate its profile electronically, the supplemental submission need only include the Internet web site electronic address ("URL").

¹⁰⁵ Instruction to rule 498(c)(3).

¹⁰⁶ Proposed rule 498 would require a fund to file the profile under rule 497, which sets out general filing requirements for fund prospectuses. The Commission proposed to include the profile requirement in new paragraph (k) to rule 497.

undertaken by others, that the profile has the potential to be used by a significant number of fund investors. To facilitate use of the profile, the Commission proposed to permit profiles to be distributed to investors through any form of media.¹¹⁵ Commenters generally supported this approach, although one commenter urged the Commission to limit distribution of the profile to mass print media, arguing that the use of electronic media or direct mail to distribute a profile could promote fraud. The Commission believes that the profile's filing requirements and its staff's periodic regular review of fund operations through its inspections program provide important safeguards against the fraudulent use of the profile. In addition, the Commission has determined that it is in the interest of fund investors to provide them with different means to access sources of information about funds. Therefore, the Commission has decided not to restrict the means that funds may use to distribute profiles.

Notwithstanding its decision to permit funds to use all media to distribute profiles, the Commission acknowledges that some media may have limitations that make communicating information in a profile difficult or that raise issues about whether investors have adequate opportunity to consider the information conveyed by that form of media.¹¹⁶

¹¹⁵ For example, a fund could make a profile available through direct mail and mass print (e.g., magazines and newspapers), broadcast, and electronic media, such as electronic bulletin boards, E-mail, facsimiles, Internet web sites, audiotapes. See e.g., Investment Company Act Release No. 21399 (Oct. 6, 1995) [60 FR 53458, 53458 n.9] ("Electronic Distribution Release"). A fund may find that posting both its profile and its prospectus (and other information) on its Internet web site may disseminate disclosure documents to investors more efficiently than other ways.

The Commission has encouraged the electronic dissemination of information by allowing funds and other types of companies significant choice in selecting and using distribution media. See, e.g., *id.* at 53460 n.20 (providing guidance on the electronic delivery of documents including prospectuses, shareholder reports, and proxies, under the Securities Act, the Securities Exchange Act, and the Investment Company Act); Investment Company Act Release No. 21945 (May 9, 1996) [61 FR 24644] (addressing the use of electronic media by broker-dealers, transfer agents, and investment advisers); Investment Company Act Release No. 21946 (May 9, 1996) [61 FR 24652] ("Release 21946") (adopting technical amendments to rules premised on the delivery of paper documents).

¹¹⁶ The Commission noted the same point generally in the Electronic Distribution Release, *supra* note 115, at 53460 & n.20. For example, broadcast media may be more difficult to use for disseminating the profile because they may not communicate the profile information effectively (e.g., the bar chart may not be effectively conveyed by a radio broadcast) or provide a meaningful

Regardless of how it is distributed (e.g., through electronic means or in paper format), a profile must contain all of the information contemplated by rule 498.¹¹⁷ In addition, while a fund's profile may be delivered without the fund's prospectus, the profile, if accompanied by supplemental sales literature, cannot be delivered without the prospectus.¹¹⁸

As discussed in the Profile Proposing Release, electronic media, such as the Internet, may be particularly well suited for the delivery of the profile to investors.¹¹⁹ Including the profile together with the prospectus (and other information) on a fund's Internet web site may be an efficient method for the fund to disseminate, and for investors to receive, disclosure documents. Electronic availability of both the profile and prospectus would allow investors to access the fund's prospectus for more information contemporaneously with deciding to make an investment in the fund.¹²⁰

opportunity for retaining the information (e.g., a short television commercial).

¹¹⁷ Release 21946, *supra* note 115, at 24653. The Commission has taken the position generally that any document contemplated by the federal securities laws, whether delivered electronically or on paper, must contain all required information and, if the order of information has been specified by the Commission, must present the information in substantially the prescribed order. Electronic Distribution Release, *supra* note 115, at 53460 n.20.

¹¹⁸ Profiles may be accompanied by material deemed to be an omitting prospectus within the meaning of rule 482 under the Securities Act. The conclusion that a profile accompanied by supplemental sales literature cannot be delivered to investors without the prospectus is based on section 2(a)(10) of the Securities Act [15 U.S.C. 77b(a)(10)], which excludes sales literature from the definition of a "prospectus" (and from the filing requirements under the Securities Act) if a section 10(a) prospectus (but not a summary prospectus under section 10(b)) precedes or accompanies the sales literature. For a discussion of the use of a profile with rule 482 materials, see *infra* notes 121 and 122 and accompanying text. See also Electronic Distribution Release, *supra* note 115, at 53463 and 53465 (examples 15 and 35).

¹¹⁹ See Profile Proposing Release, *supra* note 6, at 10951.

¹²⁰ A fund could provide a hyperlink to its prospectus from its profile. A hyperlink in a document (which, for example, may be an underlined word or phrase) permits a viewer to move to another document (or part of the same document) with a computer command. The words "investment strategies" in the profile, for example, could be set up as a hyperlink to the discussion of investment strategies in the prospectus. Using hyperlinks could facilitate the profile's serving as a means through which fund investors can obtain additional information in the prospectus and other documents. An investor's use of an electronic profile application contemplated by rule 498 would create the inference of delivery of the prospectus if both the profile and the prospectus are available at the same electronic site. *Cf.* Electronic Distribution Release, *supra* note 115, at 43565-66 (example (39)) ("If the fund can identify the application form as coming from the electronic system that contains both the application and the prospectus, electronic

Several commenters pointed out that funds could decide to send profiles to prospective investors with cover letters designed to be "omitting prospectuses" within the meaning of rule 482 under the Securities Act.¹²¹ Noting that rule 482 materials are designed for a purpose different from that of the profile and are required to contain a legend that is inconsistent with the legend in the profile, the commenters requested that the Commission clarify the circumstances under which these materials could be used with a profile. The commenters suggested specifically that the statement required by rule 482, that a prospectus is available from a fund and that the investor should read it carefully before investing, could confuse investors who receive rule 482 materials with a profile that contains an application to purchase shares of the fund. To avoid this type of confusion, the Commission is revising rule 482 so that a fund can indicate in a letter or other rule 482 material accompanying the fund's profile that information about the fund, and the procedures for investing in the fund, are available in the accompanying profile.¹²² The Commission also is revising rule 482 to provide that a profile containing, or accompanied by, an application can be used with rule 482 materials.¹²³

E. Modified Profiles for Certain Funds

The Commission proposed to permit a fund to tailor a profile for use by investors in participant-directed defined contribution plans ("plans"). The Commission believes that plan participants may find a profile helpful in evaluating and comparing the funds offered as investment alternatives in a plan.¹²⁴ In proposing rule 498, the Commission recognized that certain information of importance to typical fund investors is of little importance to participants in plans. Thus, proposed rule 498 would permit a fund offered through a plan to omit information relating to the purchase and sale of fund

delivery of the prospectus can be inferred."). A fund that does not electronically disseminate the profile and prospectus together could not rely on this presumption and generally would be required to provide a copy of the prospectus with the purchase confirmation.

¹²¹ See *supra* note 104.

¹²² Rule 482(a)(3).

¹²³ Rule 482(a)(5).

¹²⁴ The Division has taken the view that certain informational materials about a fund offered as an investment option in a defined contribution plan can be deemed an omitting prospectus within the meaning of rule 482. Fidelity Institutional Retirement Services Company, Inc. (pub. avail. Apr. 5, 1995) (staff no-action letter). None of the initiatives being adopted by the Commission today is intended to supersede this position of the Division.

shares, fund distributions, and tax consequences.¹²⁵

Commenters generally supported allowing funds to develop profiles containing disclosure of particular relevance for plan participants who invest in funds. The Commission is adopting the special provisions for profiles used for plans as proposed with modifications to reflect suggestions of the commenters.¹²⁶

Under rule 498, as adopted, funds can tailor disclosure for profiles to be used for investments in defined contribution plans qualified under the Internal Revenue Code.¹²⁷ One commenter suggested that the Commission also permit funds that serve as investment options for variable insurance contracts to modify profiles to take into account specialized purchase and sale procedures and tax consequences applicable to these funds.¹²⁸ In response to the commenter's suggestions, the Commission is revising rule 498 to permit the profile to be tailored for funds offered through variable insurance contracts. The Commission believes that this revision will help to ensure that profiles contain information that investors will find meaningful and useful. Rule 498, as adopted, permits a profile for a fund offered as an investment option for a plan to include, or be accompanied by, an enrollment form for the plan.¹²⁹ An application or enrollment form for a variable insurance contract may accompany the profile for the funds that serve as investment options, however, only if the form also

is accompanied by a full prospectus for the contract.¹³⁰

Some commenters suggested that rule 498 permit other modifications to the disclosure in fund profiles used in connection with plans, such as including information about purchases and sales of the fund's shares, taxation, or transfer of participant accounts under the plan or describing from whom this information can be obtained. Commenters also suggested that rule 498 permit such a fund to alter the legend in its profile used by plans to distinguish clearly that profile from another profile of the same fund. Consistent with the goal of providing meaningful and useful information that is effectively communicated to investors, rule 498, as adopted, permits funds to modify the legend and other disclosure in profiles intended for use in connection with defined contribution plans, other tax-deferred arrangements described in the rule, and variable insurance contracts.

III. Effective Date

The Commission proposed a transition period after the effective date of revised Form N-1A to give funds sufficient time to prepare their registration statements under the proposed amendments.¹³¹ One commenter suggested that, in light of the significant overlap of information in fund prospectuses and profiles, funds would revise their prospectuses and develop profiles concurrently, and requested that the transition period be the same for both rule 498 and Form N-1A, as amended. The commenter also requested that the Commission continue to permit funds to use Pilot Profiles during the transition period.¹³² The Commission expects that the practical result of the adoption of rule 498 and revisions to prospectus disclosure requirements may be that funds begin using both documents at the same time. In light of the profile's purpose to provide investors with a new source of

clear, concise information about funds, the Commission believes that funds should have the option to use the profile as soon as possible and is making rule 498 effective on June 1, 1998.¹³³ The amendments to Form N-1A will become effective on the same date.¹³⁴ Although existing funds will have until December 1, 1999 to comply with the Form N-1A amendments, a fund may, at its option, prepare documents in accordance with the requirements of the amended Form at any time after the effective date of the amendments.

IV. Cost/Benefit Analysis and Effects on Competition, Efficiency, and Capital Formation

Section 2(b) of the Securities Act provides that whenever the Commission engages in rulemaking requiring it to consider whether its action is in the public interest, the Commission also must consider whether the action will promote efficiency, competition, and capital formation.¹³⁵ For the reasons stated in the cost/benefit analysis below, as well as the reasons discussed elsewhere in this adopting release, the Commission has concluded that rule 498 will protect investors and will promote efficiency, competition, and capital formation.

Evaluating and comparing funds has become an increasingly difficult task for investors as the number of funds has grown. The Commission has designed the profile to allow funds to use different offering documents to meet the diverse information needs of investors. The Commission believes that rule 498 allows funds to provide investors with a profile that conveys information to investors efficiently, to the benefit of investors and funds. For example, funds may include profiles in various media, such as magazines, and may use profiles specifically tailored for investors in defined contribution plans, certain other tax-deferred arrangements, and variable insurance contracts. The profile, by providing investors with a concise, standardized information option, also may enable investors to use information

¹²⁵ Proposed rule 498(c)(4). The proposed rule also would permit funds to exclude information about some fund services (e.g., exchange privileges) that may not apply to plan participants. In addition, the proposed rule acknowledged that a plan typically effects purchases and sales of a fund's shares on behalf of plan participants and would permit the fund's profile to include the plan's enrollment form in lieu of the application form.

¹²⁶ Rule 498(d). General Instruction C.3.(d) of Form N-1A includes similar provisions enabling funds to omit certain information from their prospectuses that are used in connection with plans. Form N-1A Release, *supra* note 1.

¹²⁷ In addition to plans under rule 401(k) of the Internal Revenue Code [26 U.S.C. 401(k)], these plans include those under section 403(b) [26 U.S.C. 403(b)] (available to employees of certain tax-exempt organizations and public educational systems) and section 457 [26 U.S.C. 457] (available to employees of state and local governments and other tax-exempt employers).

¹²⁸ The prospectus for a variable insurance contract discloses the purchase and sale procedures and tax consequences of investing in the contract and is provided to investors in addition to prospectuses for one or more funds that are offered as investment options under the contract. Use of a profile for the available investment options could make it easier for investors in variable contracts to compare and select from the investment alternatives available under the contract.

¹²⁹ Rule 498(d)(3).

¹³⁰ The Commission is currently considering whether it should extend the profile to variable annuity contracts. See *supra* note 39 and accompanying text. The staff of the Division has indicated that, for variable annuity contracts used to fund employee retirement plans, summaries of the contract and fund prospectuses, accompanied by payroll deduction and allocation forms, could be treated as satisfying the requirements of rule 482 under certain circumstances. See Aetna Life Insurance and Annuity Co. (pub. avail. Jan. 6, 1997) (staff no-action letter). A profile could be used as a summary of a fund prospectus for these purposes.

¹³¹ See Form N-1A Proposing Release, *supra* note 7, at 10921.

¹³² In the 1977 Profile Letter, *supra* note 8, the Division stated that the Commission would address the transition from use of a Pilot Profile in connection with the adoption of proposed rule 498.

¹³³ After the effective date of rule 498, funds could continue to use a Pilot Profile as supplemental sales literature.

¹³⁴ To simplify compliance with rule 498 and the revised prospectus disclosure requirements, the Commission is specifying the same effective date for both as June 1, 1998. All new registration statements or post-effective amendments that are annual updates to effective registration statements filed after December 1, 1998 must comply with the amendments to Form N-1A. The final compliance date for filing amendments to effective registration statements to conform with the new Form N-1A requirements is December 1, 1999. See Form N-1A Release, *supra* note 1.

¹³⁵ 15 U.S.C. 77b(b). See also section 2(c) of the Investment Company Act [15 U.S.C. 80a-2(c)].

efficiently by making it easier to compare funds before investing. This result will promote competition among funds and better enable investors to select an investment that is appropriate and consistent with their investment goals.

The Commission did not receive any comments addressing specifically the cost associated with rule 498. Acknowledging that it is difficult to quantify costs and benefits related to the use of a profile, the Commission notes that commenters strongly favored the proposal. A fund's use of a profile under rule 498 is voluntary and not every fund will choose to prepare a profile. Developing a profile consistent with rule 498, however, would not be burdensome, because a fund that chooses to use a profile is likely to have developed much of the information required to appear in a profile as a part of its registration statement on Form N-1A. As discussed in the Commission's Paperwork Reduction Act submission in conjunction with the Profile Proposing Release, the Commission estimated that approximately 2,500 funds, or one third of eligible funds, will prepare profiles, and that the average profile will describe 2 funds. The Commission estimated that the annual cost to the industry of preparing and filing updated profiles would be approximately \$5,600,000.¹³⁶

The Commission anticipates that the use of profiles may cause funds to restructure their expenditures on advertising. It is difficult, however, to determine how the use of profiles will affect aggregate expenditures on advertising. Expenditures on profiles may be offset by reductions in other advertising costs, resulting in no net cost increase.

The Commission has taken steps to minimize the costs associated with the use of a profile, such as designing the required risk/return summary to allow funds to update return information without necessitating the reprinting of the entire profile. The ability to provide better information to investors and encourage investments in a fund may offset any additional costs to funds created by the development of a profile. Profiles also may lead to lower printing and distribution costs for funds that mail fewer prospectuses. On balance, the Commission believes that rule 498 fosters efficiency and tends to promote competition and capital formation without imposing significant costs on funds.

V. Paperwork Reduction Act

As set forth in the Profile Proposing Release, this rulemaking contains "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA").¹³⁷ The collection of information requirements in the Profile Proposing Release were submitted to the Office of Management and Budget ("OMB") for review under section 3507(d) of the PRA. OMB approved the collection of information under the title "Profiles for Open-End Management Investment Companies" and assigned it control number 3235-0488. The collection of information contained in the Profile Proposing Release is in accordance with the clearance requirements of 44 U.S.C. 3507. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless an agency displays a valid OMB control number.

Rule 498 permits funds to provide investors with a profile that contains a summary of key information about a fund. A fund that chooses to make a profile available would give investors the option of purchasing the fund's shares after reviewing the information contained in the profile or after requesting and reviewing the fund's prospectus (and other information about the fund). Under rule 498, use of the profile by a fund is voluntary, but compliance with the rule is mandatory for any fund that decides to use a profile. Responses to the collection of information will not be confidential.

The Profile Proposing Release solicited public comment on the collection of information requirements contained in that release. The Commission received no comments on the PRA portion of the release. The estimated total reporting burden, purpose, use and necessity of the collection of information, as detailed in the Profile Proposing Release, remains the same.

VI. Summary of Final Regulatory Flexibility Analysis

A summary of the Initial Regulatory Flexibility Analysis ("Analysis"), which was prepared in accordance with the Regulatory Flexibility Act, 5 U.S.C. 603, was published in the Profile Proposing Release. The Commission received no comments on the Analysis. The Commission has prepared a Final Regulatory Flexibility Analysis ("FRFA") in accordance with 5 U.S.C. 604. The FRFA explains that a profile

would include a summary of key information about a fund in a concise, standardized format designed to help investors evaluate and compare funds. The FRFA also explains that, if a fund makes a profile available, investors will have the option to purchase the fund's shares after reviewing the information in the profile or after requesting and reviewing the fund's prospectus (and other information about the fund). An investor deciding to purchase fund shares based on the information in the profile would receive the fund's prospectus no later than with the confirmation of the purchase.

The FRFA discusses the effect of rule 498 on small entity investment companies, which are defined, for the purposes of the Securities Act and Investment Company Act, as investment companies with net assets of \$50 million or less as of the end of the most recent fiscal year [17 CFR 230.157(b) and 270.0-10]. The Commission estimates that there are approximately 620 small entity investment companies and that approximately one-third (207) could choose to use proposed rule 498. As explained in more detail in the FRFA, the Commission estimates that the total hour burden on small entities to prepare, file, and update the profile annually would be approximately 2,420 hours. While the profile would include a summary of key information about the fund that is included in the prospectus, the disclosure requirements for the profile and the prospectus are designed for different purposes.

The FRFA explains that rule 498 would not be significantly burdensome for small entity investment companies because use of the profile is optional, and the information to be included in a fund's profile will typically be drawn from information required to be disclosed in the fund's prospectus. In addition, some investors may use profiles instead of prospectuses to narrow their choices among funds, which would reduce a fund's printing and distribution costs. Lower printing and distribution costs could benefit small entities as much as or more than it could for large funds.

As stated in the FRFA, the Commission considered several alternatives to rule 498, including establishing different compliance or reporting requirements for small entity investment companies or exempting them from all or part of the rule. Because use of the profile would be optional, and, if used, profiles of all funds would be subject to the same disclosure requirements, the Commission believes that the rule would not impose additional burdens

¹³⁶ Profile Proposing Release, *supra* note 6.

¹³⁷ 44 U.S.C. 3501, *et seq.*

on small entity investment companies. Separate treatment for small entity investment companies would be inconsistent with the protection of investors.

A copy of the Final Regulatory Flexibility Analysis may be obtained by contacting George J. Zornada, Team Leader, Office of Disclosure Regulation, Division of Investment Management, Securities and Exchange Commission, 450 Fifth Street, NW., Mail Stop 5-6, Washington, DC 20549-6009.

VII. Statutory Authority

The Commission is adopting rule 498 under sections 5, 7, 8, 10, and 19(a) of the Securities Act [15 U.S.C. 77e, 77g, 77h, 77j, and 77s(a)] and sections 8, 22, 24(g), 30, and 38 of the Investment Company Act [15 U.S.C. 80a-8, 80a-22, 80a-24(g), 80a-29, and 80a-37]. The authority citations for the rule precede the text of the amendments.

List of Subjects in 17 CFR Parts 230 and 270

Investment companies, Reporting and recordkeeping requirement, Securities.

Text of Rule

For the reasons set out in the preamble, the Commission amends chapter II, title 17 of the Code of Federal Regulations as follows:

PART 230—GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933

1. The general authority citation for part 230 is revised to read, in part, as follows:

Authority: 15 U.S.C. 77b, 77f, 77g, 77h, 77j, 77r, 77s, 77sss, 78c, 78d, 78l, 78m, 78n, 78o, 78w, 78ll(d), 79t, 80a-8, 80a-24, 80a-28, 80a-29, 80a-30, and 80a-37, unless otherwise noted.

* * * * *

2. Amend § 230.431 to revise the introductory text of paragraph (a) to read as follows:

§ 230.431 Summary prospectuses.

(a) A summary prospectus prepared and filed (except a summary prospectus filed by an open-end management investment company registered under the Investment Company Act of 1940) as part of a registration statement in accordance with this section shall be deemed to be a prospectus permitted under section 10(b) of the Act (15 U.S.C. 77j(b)) for the purposes of section 5(b)(1) of the Act (15 U.S.C. 77e(b)(1)) if the form used for registration of the securities to be offered provides for the use of a summary prospectus and the following conditions are met:

* * * * *

3. Amend § 230.482 to revise the introductory text of paragraph (a), paragraphs (a)(3), (a)(5), and (a)(7), and in paragraph (d) remove the period at the end of paragraph (d)(1)(ii) and add in its place “; or” and add paragraph (d)(1)(iii) to read as follows:

§ 230.482 Advertising by an investment company as satisfying requirements of section 10.

(a) An advertisement or other sales material that is not a prospectus, or an advertisement or sales material excluded from the definition of prospectus by section 2(10) of the Act (15 U.S.C. 77b(10)) and related § 230.134, will be deemed to be a prospectus under section 10(b) of the Act (15 U.S.C. 77j(b)) for the purpose of section 5(b)(1) of the Act (15 U.S.C. 77e(b)(1)), if:

* * * * *

(3) It includes a conspicuous statement that:

(i) Identifies a source from which an investor may obtain a prospectus containing more complete information about the investment company, which should be read carefully before investing; or

(ii) If used with a profile under § 230.498 (“Profile”), indicates that information is available in the Profile about the investment company, the procedures for investing in the investment company, and the availability of the investment company's prospectus.

Note to Paragraph (a)(3). The fact that the statements included in the advertisement are included in the section 10(a) prospectus does not relieve the issuer, underwriter, or dealer of the obligation to ensure that the advertisement is not false or misleading.

* * * * *

(5) It does not contain and is not accompanied by any application by which a prospective investor may invest in the investment company, except that:

(i) A prospectus meeting the requirements of section 10(a) of the Act (15 U.S.C. 77j(a)) by which a unit investment trust offers periodic payment plan certificates may contain a contract application although the prospectus includes another prospectus that, pursuant to this section, omits certain information required by section 10(a) of the Act, regarding investment companies in which the unit investment trusts invests; and

(ii) It may be used with a Profile that includes, or is accompanied by, an application to purchase shares of the investment company as permitted under § 230.498.

* * * * *

(7)(i) In the case of an investment company that holds itself out to be a money market fund, it includes the following statement:

An investment in the Fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although the Fund seeks to preserve the value of your investment at \$1.00 per share, it is possible to lose money by investing in the Fund.

(ii) A money market fund that does not hold itself out as maintaining a stable net asset value may omit the second sentence of the statement in (a)(7)(i) of this section.

* * * * *

(d) * * *

(1) * * *

(iii) A quotation or quotations of tax equivalent yield or tax equivalent effective yield if it appears in the same advertisement as a quotation of current yield and each quotation relates to the same base period as the quotation of current yield, is presented with equal prominence, and states the income tax rate used in the calculation.

* * * * *

4. Amend § 230.497 to revise paragraph (a) and to add paragraph (k) to read as follows:

§ 230.497 Filing of investment company prospectuses—number of copies.

(a) Five copies of every form of prospectus sent or given to any person prior to the effective date of the registration statement that varies from the form or forms of prospectus included in the registration statement filed pursuant to § 230.402(a) shall be filed as part of the registration statement not later than the date that form of prospectus is first sent or given to any person, except that:

(1) An investment company advertisement under § 230.482 shall be filed under this paragraph (a) (but not as part of the registration statement) unless filed under paragraph (i) of this section; and

(2) A profile under § 230.498 shall be filed in accordance with paragraph (k) of this section and not as part of the registration statement.

* * * * *

(k)(1) *Profile filing requirements.* A form of profile under § 230.498 shall not be used unless:

(i) The form of profile that has not been previously filed with the Commission is filed at least 30 days before the date that it is first sent or given to any person.

(A) No additional filing is required during the 30-day period for changes (material or otherwise) to a form of

profile filed under this paragraph if the changes are included in the definitive profile that is filed with the Commission under paragraph (k)(2)(ii) of this section.

(B) The form of profile filed under this paragraph (k)(1)(i) can be used on the later of 30 days after the date of filing or, if the profile is filed in connection with an initial registration statement or a post-effective amendment that adds a series of an investment company to a registration statement, or reflects changes to a prospectus included in a post-effective amendment filed to update a registration statement under § 230.485, the date that the registration statement or post-effective amendment becomes effective.

(ii) A definitive form of a profile filed under paragraph (k)(1)(i) of this section is filed with the Commission no later than the fifth business day after the date that it is used.

(iii) A form of profile that differs from any definitive form of profile that was filed under this paragraph (k) is filed with the Commission in definitive form no later than the fifth business day after the date that it is first used. This filing shall be made under one of the following according to the character of the change contained in the form of profile:

(A) A form of profile that contains a material change to the information disclosed under § 230.498 (c)(2)(i)–(iii); and

(B) A form of profile that does not contain a material change to the information under § 230.498 (c)(2)(i)–(iii).

(2) *Filing procedures.* (i) Designate, at the top of the first page of any form of profile that is filed under this paragraph (k), the paragraph and sub-paragraph under which the profile is filed.

(ii) Send two additional copies of the first definitive form of profile filed electronically under paragraph (k)(1)(ii) of this section to the Commission, in the primary form intended to be used for distribution to investors (e.g., paper, electronic media), by mail or other means reasonable calculated to result in receipt by the Commission, no later than the fifth business day after the date the profile is first sent or given to any person. Send copies to the following address: Office of Disclosure and Review, Division of Investment Management, U.S. Securities and Exchange Commission, 450 Fifth St., N.W., Mail Stop 5–6, Washington, D.C. 20549–6009. Note prominently that the submission is made in accordance with § 230.497(k)(2) of Regulation C under the Securities Act. If the profile is distributed primarily on the Internet, supply, in lieu of copies, the electronic

address (“URL”) of the profile page(s) in an exhibit to the electronic filing under this paragraph (k). This additional requirement will expire on June 1, 2000.

5. Add § 230.498 under the undesignated center heading “Regulation C—Registration” to read as follows:

§ 230.498 Profiles for certain open-end management investment companies.

(a) *Definitions.* (1) A *Fund* means an open-end management investment company, or any series of such a company, that has, or is included in, an effective registration statement on Form N–1A (§§ 274.11A and 239.15A of this chapter) and that has a current prospectus under section 10(a) of the Act (15 U.S.C. 77j(a)).

(2) A *Profile* means a summary prospectus that is authorized under section 10(b) of the Act (15 U.S.C. 77j(b)) and section 24(g) of the Investment Company Act (15 U.S.C. 80a–24(g) for the purpose of section 5(b)(1) of the Act (15 U.S.C. 77e(b)(1))).

(b) *General requirements.* A Fund may provide a Profile to investors, which may include, or be accompanied by, and application that investors may use to purchase the Fund’s shares, if the Profile contains the information required or not precluded by paragraph (c) of this section and does not incorporate any information by reference to another document.

Instructions to paragraph (b).

1. The Profile is intended to be a standardized summary of key information in the Fund’s prospectus under section 10(b) of the Act. Additional information is available in the Fund’s prospectus under section 10(a) of the Act, in the Fund’s Statement of Additional Information under Form N–1A, and in the Fund’s annual and semi-annual shareholder reports prepared in accordance with § 270.30d–1. Funds may not use cross-references in the Profile to other Fund disclosure documents unless required or permitted by this rule. Funds should minimize cross-reference and the use of footnotes within the Profile; cross-references and footnotes should generally be used only to promote a better understanding of the information about the Fund contained in the Profile.

2. Provide clear and concise information in the Profile in a format designed to communicate the information effectively. Avoid excessive detail, technical or legal terms, and long sentences and paragraphs. Provide the information in the Profile using the plain English writing principles in § 230.421(d).

3. A Fund may use document design techniques intended to promote effective communication of the information in the Profile unless inconsistent with the requirements of this section.

4. A Profile may describe more than one Fund or class of a Fund. A Profile that offers

the securities of more than one Fund or class of a Fund does not need to repeat information that is the same for each Fund or class of Fund described in the Profile.

5. File the Profile with the Commission as required by § 230.497(k).

(c) *Specific requirements.* (1) Include on the cover page of the Profile or at the beginning of the Profile:

(i) The Fund’s name and, at the Fund’s option, the Fund’s investment objective or the type of fund or class offered, or both;

(ii) A statement identifying the document as a “Profile,” without using the term “prospectus”;

(iii) The approximate date of the Profile’s first use;

(iv) The following legend:

This Profile summarizes key information about the Fund that is included in the Fund’s prospectus. The Fund’s prospectus includes additional information about the Fund, including a more detailed description of the risks associated with investing in the Fund that you may want to consider before you invest. You may obtain the prospectus and other information about the Fund at no cost by calling _____.

(v) Provide a toll-free (or collect) telephone number that investors can use to obtain the prospectus and other information. The Fund may indicate, as applicable, that the prospectus and other information is available on the Fund’s Internet site or by E-mail request. The Fund also may indicate, if applicable, that the prospectus and other information is available from a financial intermediary (such as a broker-dealer or bank) through which shares of the Fund may be purchased or sold.

Instruction to Paragraph (c)(1)(v). When the Fund (or financial intermediary through which shares of the Fund may be purchased or sold) receives a request for the Fund’s prospectus, the Fund’s Statement of Additional Information, or the Fund’s annual or semi-annual report, the Fund (or financial intermediary) must send the requested document within three business days of receipt of the request, by first-class mail or other means designed to ensure equally prompt delivery. Funds are encouraged to send other information requested by shareholders within the same period.

(2) Provide the information required by paragraphs (c)(2) (i) through (ix) of this section in the order indicated:

(i) *Fund objectives/goals.* Provide the information about the Fund’s investment objectives or goals required by Item 2(a) of Form N–1A.

(ii) *Principal investment strategies of the Fund.* Provide the information about the Fund’s principal investment strategies required by Item 2(b) of Form N–1A. In addition, a Fund (other than a Fund that has not yet been required to deliver a semi-annual or annual

report under § 270.30d-1 of this chapter) must provide disclosure to the following effect:

Additional information about the Fund's investments is available in the Fund's annual and semi-annual reports to shareholders. In the Fund's annual report you will find a discussion of the market conditions and investment strategies that significantly affected the Fund's performance during the last fiscal year. You may obtain either or both of these reports at no cost by calling _____.

(iii) *Principal risks of investing in the Fund.* Provide the narrative disclosure, bar chart, and table required by Item 2(c) of Form N-1A. Provide in the table the Fund's average annual total returns and, if applicable, yield as of the end of the most recent calendar quarter prior to the Profile's first use. Update the return information as of the end of each succeeding calendar quarter as soon as practicable after the completion of the quarter. Disclose the date of the return information adjacent to the table.

Instruction to Paragraph (c)(2)(iii). A Fund may reflect the updated performance information in this section of the profile by affixing a label or sticker, or by other reasonable means.

(iv) *Fees and expenses of the Fund.* Include the fee table required by Item 3 of Form N-1A.

(v) *Investment adviser, sub-adviser(s) and portfolio manager(s) of the Fund.*

(A) Identify the Fund's investment adviser.

(B) Identify the Fund's sub-adviser(s) (if any) except that:

(1) A Fund need not identify a sub-adviser(s) whose sole responsibility for the Fund is limited to day-to-day management of the Fund's holdings of cash and cash equivalent instruments, unless the Fund is a money market fund or other Fund with a principal investment strategy of regularly holding cash and cash equivalent instruments.

(2) A Fund having three or more sub-advisers, each of which manages a portion of the Fund's portfolio, need not identify each such sub-adviser, except that the Fund must identify any sub-adviser that is (or is reasonably expected to be) responsible for the management of a significant portion of the Fund's net assets. For purposes of this paragraph (c)(2)(v)(B)(2), a significant portion of a Fund's net assets generally will be deemed to be 30% or more of the fund's net assets.

(C) State the name and length of service of the person or persons employed by or associated with the Fund's investment adviser (or the Fund) who are primarily responsible for the day-to-day management of the Fund's portfolio and summarize each person's

business experience for the last five years in accordance with the Instructions to Item 6(a)(2) of Form N-1A. A Fund with three or more such persons, each of whom is (or is reasonably expected to be) responsible for the management of a portion of the Fund's portfolio, need not identify each person, except that a Fund must identify and summarize the business experience for the last five years of each person who is (or is reasonably expected to be) responsible for the management of a significant portion of the Fund's net assets. For purposes of this paragraph (c)(2)(v)(C), a significant portion of a Fund's net assets generally will be deemed to be 30% or more of the Fund's net assets.

(vi) *Purchase of Fund shares.* Disclose the Fund's minimum initial or subsequent investment requirements, the initial sales load (or other loads) to which the Fund's shares are subject, and, if applicable, the initial sales load breakpoints or waivers.

(vii) *Sale of Fund shares.* Disclose that the Fund's shares are redeemable, identify the procedures for redeeming shares (e.g., on any business day by written request, telephone, or wire transfer), and identify any charges or sales loads that may be assessed upon redemption (including, if applicable, the existence of waivers of these charges).

(viii) *Fund distributions and tax information.* Describe how frequently the Fund intends to make distributions and what options for reinvestment of distributions (if any) are available to investors. State, as applicable, that the Fund intends to make distributions that may be taxed as ordinary income or capital gains (which may be taxable at different rates depending on the length of time that the Fund holds its assets) or that the Fund intends to distribute tax-exempt income. If a Fund expects that its distributions, as a result of its investment objectives or strategies, primarily will consist of ordinary income or capital gains, provide disclosure to that effect. For a Fund that holds itself out as investing in securities generating tax-exempt income, provide, as applicable, a general statement to the effect that a portion of the Fund's distributions may be subject to federal income tax.

(ix) *Other services are available from the Fund.* Provide a brief summary of services available to the Fund's shareholders (e.g., any exchange privileges or automated information services), unless otherwise disclosed in response to paragraphs (c)(2)(vi) through (viii) of this section.

Instruction to Paragraph (c)(2)(ix). A Fund should disclose only those services that generally are available to typical investors in the Fund.

(3) The Profile may include an application that a prospective investor can use to purchase the Fund's shares as long as the application explains with equal prominence that an investor has the option of purchasing shares of the Fund after reviewing the information in the Profile or after requesting and reviewing the Fund's prospectus (and other information) before making a decision about investing in the Fund.

Instruction to Paragraph (c)(3). a Fund may include the application in a Profile or otherwise provide an application together with a Profile in any manner reasonably designed to alert investors that the application is to be considered along with the information about the Fund disclosed in the Profile.

(d) *Modified Profile for certain funds.*

(1) A Fund may modify or omit the information required by paragraphs (c)(2)(vi) through (ix) of this section for a Profile to be used for a Fund that is offered as an investment option for:

(i) A defined contribution plan that meets the requirements for qualification under section 401(k) of the Internal Revenue Code (26 U.S.C. 401(k));

(ii) A tax-deferred arrangement under section 403(b) or 457 of the Internal Revenue Code (26 U.S.C. 403(b) and 457); and

(iii) Variable contracts as defined in section 817(d) of the Internal Revenue Code (26 U.S.C. 817(d)).

(2) A Fund that uses a Profile permitted under paragraph (d)(1) of this section may:

(i) Alter the legend required by paragraph (c)(1)(iv) of this section to include a statement to the effect that the Profile is intended for use in connection with a defined contribution plan, another tax-deferred arrangement, or a variable contract, as applicable, and is not intended for use by other investors; and

(ii) Modify other disclosure in a Profile consistent with offering the Fund as a specific investment option for a defined contribution plan, tax-deferred arrangement, or variable contract.

(3) A Profile used under paragraph (d)(1)(i) or (ii), but not paragraph (d)(1)(iii), of this section may include, or be accompanied by, an enrollment form for the plan or arrangement. The enrollment form does not need to be filed with the Profile under § 230.497.

**PART 270—RULES AND
REGULATIONS, INVESTMENT
COMPANY ACT OF 1940**

6. The general authority citation for part 270 is revised to read, in part, as follows:

Authority: 15 U.S.C. 80a-1 *et seq.*, 80a-34(d), 80a-37, 80a-39 unless otherwise noted:

* * * * *

7. Amend § 270.34b-1 to revise paragraph (b)(1)(ii)(B) to read as follows:

§ 270.34b-1 Sales literature deemed to be misleading.

* * * * *

(b)(1) * * *

(ii) * * *

(B) Accompany any quotation of the money market fund's tax equivalent yield or tax equivalent effective yield

with a quotation of current yield as specified in § 230.482(d)(1)(iii) of this chapter; and

* * * * *

Dated: March 13, 1998.

By the Commission.

Margaret H. McFarland,

Deputy Secretary.

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