SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 230, 239, 270, and 274

[Release Nos. 33–8101; 34–45953; IC–25575; File No. S7–17–02]

RIN 3235–AH19

Proposed Amendments to Investment Company Advertising Rules

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission is proposing rule and form amendments under the Securities Act of 1933 and the Investment Company Act of 1940 to provide registered investment companies and business development companies with the ability to disclose more timely information in advertisements and to reinforce the antifraud protections that apply to investment company advertisements. The proposed amendments would implement a provision of the National Securities Markets Improvement Act of 1996 by permitting the use of a prospectus under section 10(b) of the Securities Act with respect to securities issued by an investment company that includes information the substance of which is not included in the investment company's statutory prospectus. The proposed amendments also would require enhanced disclosure in investment company advertisements and are designed to encourage advertisements that convey balanced information to prospective investors, particularly with respect to past performance.

DATES: Comments must be received on or before July 31, 2002.

ADDRESSES: Comments should be submitted in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 5th Street, NW., Washington, DC 20549–0609. Comments also may be submitted electronically at the following E-mail address: *rule-comments@sec.gov.* All comment letters should refer to File No. S7–17–02; this file number should be included on the subject line if E-mail is used. All comments received will be available for public inspection and copying in the Commission's Public Reference Room, 450 5th Street, NW., Washington, DC 20549–0102. Electronically submitted comment letters will also be posted on the Commission's Internet site (*http://www.sec.gov*).[1]

FOR FURTHER INFORMATION CONTACT: Christopher P. Kaiser, Attorney, David S. Schwartz, Attorney, or Paul G. Cellupica, Assistant Director, at (202) 942–0721, Office of Disclosure Regulation, Division of Investment Management, Securities and Exchange Commission, 450 5th Street, NW., Washington, DC 20549–0506.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission (''Commission'') is proposing for comment amendments to rule 134 [17 CFR 230.134], rule 156 [17 CFR 230.156], and rule 482 [17 CFR 230.482] under the Securities Act of 1933 [15 U.S.C. 77a *et seq.*] (''Securities Act'') and rule 34b-1 [17 CFR 270.34b-1] under the Investment Company Act of 1940 [15 U.S.C. 80a-1 *et seq.*] (''Investment Company Act''). The Commission also is proposing for comment technical amendments to Form N–1A [17 CFR 239.15A and 274.11A], Form N–3 [17 CFR 239.17a and 274.11b], Form N–4 [17 CFR 239.17b and 274.11c], and Form N–6 [17 CFR 239.17c and 274.11d], registration forms used by investment companies to register under the Investment Company Act and to offer their securities under the Securities Act.

Table of Contents

[1] We do not edit personal, identifying information, such as names or E-mail addresses, from electronic submissions. Submit only information that you wish to make publicly available.

I. Introduction and Background

Like most issuers of securities, when an investment company (''fund'') offers its shares to the public, its promotional efforts become subject to the advertising restrictions of the Securities Act. Congress imposed these restrictions so that investors would base their investment decisions on the full disclosures contained in the ''statutory prospectus,'' which Congress intended to be the primary selling document.[2] The advertising restrictions of the Securities Act cause special problems for many investment companies, particularly for open-end management investment companies (''mutual funds'') and other investment companies that continuously offer and sell their shares.[3] For these funds, the advertising restrictions apply continuously because the offering process, in effect, is continuous.

In recognition of these problems, the Commission has adopted special advertising rules for investment companies. The most important of these is rule 482 under the Securities Act, which permits investment companies to advertise investment performance data, as well as other information.[4] Rule 482 advertisements are ''prospectuses'' under section 10(b) of the Securities Act (so-called ''omitting prospectuses''),[5] which means that, historically, they

[2] ''Statutory prospectus'' refers to the full prospectus required by Section 10(a) of the Securities Act. 15 U.S.C. 77j(a).

[3] An open-end management investment company (''mutual fund'') is an investment company, other than a unit investment trust or face-amount certificate company, that offers for sale or has outstanding any redeemable security of which it is the issuer. Sections 4 and 5(a)(1) of the Investment Company Act [15 U.S.C. 80a–4 and 80a–5(a)(1)]. Mutual funds typically offer and sell their shares continuously to provide an ongoing flow of capital into their portfolios and to enable them to meet redemption requests from outgoing shareholders.

A unit investment trust (''UIT'') is ''an investment company which (A) is organized under a trust indenture, contract of custodianship or agency, or similar instrument, (B) does not have a board of directors, and (C) issues only redeemable securities, each of which represents an undivided interest in a unit of specified securities; but does not include a voting trust.'' Section 4(2) of the Investment Company Act [15 U.S.C. 80a–4(2)]. UITs typically have active secondary markets in which the trusts' sponsors are continuously purchasing and selling the trusts' units.

A face-amount certificate is a security that obligates the issuer to pay a stated (or determinable) amount on a fixed (or determinable) date or series of dates more than twenty-four months after the date of issuance. Section 2(a)(15) of the Investment Company Act [15 U.S.C. 80a–2(a)(15)]. A face-amount certificate company is an investment company that engages or proposes to engage in the business of issuing certain face-amount certificates. Section 4(1) of the Investment Company Act [15 U.S.C. 80a–4(1)].

[4] 17 CFR 230.482.

[5] 15 U.S.C. 77j(b).

could only contain information the ''substance of which'' is included in the statutory prospectus.[6] In the National Securities Markets Improvement Act of 1996 (''NSMIA''), Congress amended the Investment Company Act to permit, subject to rules adopted by the Commission, the use of prospectuses under section 10(b) of the Securities Act that include information the substance of which is not included in the statutory prospectus.[7] Today, we are proposing to amend rule 482 and make other related rule and form changes to implement this legislation, which will provide funds with the ability to include more timely information in their advertisements, *e.g.,* information about current economic conditions that normally would not be included in a fund's prospectus. The proposed amendment will also permit funds to eliminate from the statutory prospectus boilerplate disclosure that clutters the statutory prospectus and obscures other important information.

At the same time, we are proposing amendments to the fund advertising rules that are intended to reinforce antifraud protections and encourage the provision of information to investors that is more balanced and informative, particularly in the area of investment performance. Many funds experienced extraordinary performance during 1999 and 2000, particularly funds investing in technology and Internet stocks.[8] Eager to attract new investors, many of these funds engaged in advertising campaigns focusing on past performance.[9] We became concerned that some funds, when advertising their performance, may resort to techniques that create unrealistic investor expectations or may mislead potential investors.

The Commission has undertaken a series of initiatives to address trends in the area of performance advertising. We have engaged in education efforts to caution investors against the dangers of chasing fund performance and focusing only on short-term asset growth.[10] Our staff has conducted a special review of fund marketing materials, as well as examinations of funds that have employed aggressive marketing practices.[11] And we have instituted enforcement actions based on misleading fund advertising.[12] Today's proposed amendments are part of our continuing efforts to raise the bar for fund performance advertising so that investors are informed, and not misled, by that advertising.

A. Fund Advertising Rules

Section 5 of the Securities Act contains prohibitions regarding the dissemination of written selling material to investors during the offering period. Section 5(b)(1) makes it unlawful to use interstate commerce to transmit any prospectus relating to a security with respect to which a registration statement has been filed unless the prospectus meets the requirements of section 10 of the Securities Act.[13] ''Prospectus'' is broadly defined in section 2(a)(10) to include any advertisement or other communication, ''written or by radio or television, which offers any security for sale or confirms the sale of any security.'' [14] Thus, advertisements are considered prospectuses under the Securities Act if they offer a security for sale. Because the term ''offer'' is defined and interpreted broadly to encompass any attempt to procure orders for a security, written and radio or television advertisements relating to a security, or aiding in the selling effort with respect to a security, generally must be in the form of a section 10 prospectus.[15]

There is a limited exception to the general requirement that written and radio or television offers after the filing of a registration statement must be in the form of a section 10 prospectus. So-called ''supplemental sales literature'' may be used after the effective date of a registration statement if accompanied or preceded by the statutory prospectus.[16] In addition, the use of ''tombstone'' advertisements is permitted under limited circumstances without prior delivery of the statutory prospectus.[17]

The advertising restrictions of the Securities Act cause special problems for many investment companies. Unlike typical corporate issuers that generally offer their shares only periodically, mutual funds typically offer and sell their shares continuously to provide an ongoing flow of capital into their portfolios and to enable them to meet redemption requests from outgoing shareholders. Unit investment trusts (''UITs'') typically have active secondary markets in which the trusts' sponsors are continuously purchasing and selling the trusts' units. For mutual funds and UITs, the advertising restrictions apply continuously because the offering process, in effect, is continuous. In recognition of this issue, the Commission has adopted special advertising rules for investment companies.

Rule 482

The Commission adopted rule 482 under the authority of section 10(b) of the Securities Act, which permits the Commission to adopt rules that provide for a prospectus that ''omits in part'' or ''summarizes'' information contained in the statutory prospectus.[18] Rule 482

[6] 17 CFR 230.482(a)(2).

[7] National Securities Markets Improvement Act of 1996, Pub. L. No. 104–290, 110 Stat. 3416, 3428, Section 204.

[8] In 1999, for example, more than 200 funds had returns of more than 200 percent. Gavin Daly, *SEC Reviewing Performance-Based Ads* (Mar. 29, 2000) (visited June 13, 2000) http://www.ignites.com/. In particular, funds investing in technology and Internet stocks achieved unusually high returns. Humberto Cruz, *Don't Let Numbers Mislead,* Sun-Sentinel, Feb. 13, 2000, at 5F.

[9] *See* Cruz, *supra* note 8 (stating that ''[y]ou can't pick up a financial magazine these days or tune in to financial television without running into mutual fund ads like * * * 'Heavenly,' 'We're Still Celebrating,' 'With Performance Like This,' [and] 'Operators Are Standing By.' ''); Tony Lystra, *Fund Advertising Spending Jumped in 2000,* Mutual Fund Market News, Apr. 23, 2001 (''Mutual fund companies spent 22 percent more on advertising [in 2000] than in 1999 as they touted their products' improved performance in a bull market.''); Simon London, *The Managers Who Mislead Us: Controls Are Needed to Stop Absolute Performance Statistics Being Quoted Out Of Context,* The Financial Times, Mar. 11, 2000, at 6 (''[T]he strength of world equity markets over the past decade has given managers some unusually eye-catching statistics to play with.'').

[10] *See* Securities and Exchange Commission, *Mutual Fund Investing: Look at More Than a Fund's Past Performance* (last modified Jan. 24, 2000) http://www.sec.gov/investor/pubs/mfperform.htm.

[11] Securities and Exchange Commission, *Supplementary News Material: Special Review of Fund Advertising Fact Sheet* (last modified Feb. 23, 2001) http://www.sec.gov/news/extra/funadfct.htm; Paul F. Roye, Director, Division of Investment Management, ''Challenges for the Mutual Fund Industry in the Competitive Frontier,'' Remarks at the 2000 Mutual Funds and Investment Management Conference, Palm Desert, Ca. (Mar. 27, 2000) (transcript available at http://www.sec.gov/news/speech/speecharchive/200speech.shtml).

[12] For a discussion of these enforcement actions, see note 39 *infra* and accompanying text.

[13] 15 U.S.C. 77e(b)(1).

[14] 15 U.S.C. 77b(a)(10).

[15] Section 2(a)(3) of the Securities Act defines the term ''offer'' to include ''every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value.'' 15 U.S.C. 77b(a)(3).

[16] Under section 2(a)(10) of the Securities Act, supplemental sales literature is not considered to be a prospectus and, as a result, is not subject to section 5(b)(1) of the Securities Act.

[17] ''Tombstone'' advertisements are permitted by section 2(a)(10)(b) of the Securities Act, which provides that an advertisement or other communication in respect of a security shall not be deemed a prospectus: If it states from whom a written prospectus meeting the requirements of section 10 may be obtained and, in addition, does no more than identify the security, state the price thereof, state by whom orders will be executed, and contain such other information as the Commission, by rules or regulations deemed necessary or appropriate in the public interest and for the protection of investors * * * may permit. 15 U.S.C. 77b(a)(10)(b).

[18] 15 U.S.C. 77j(b). *See also* Investment Company Act Release No. 10852 (Aug. 31, 1979) [44 FR 52816

Continued

permits registered investment companies and business development companies to advertise any information ''the substance of which'' is included in the statutory prospectus.[19] The theory behind the ''substance of which'' requirement is that an advertisement cannot be one that ''omits'' information from the statutory prospectus unless all of the information in the advertisement is derived from information in the statutory prospectus.[20] Significantly, rule 482 provides a means for mutual funds to advertise performance information according to standardized formulas.[21]

Because a rule 482 advertisement is a prospectus under section 10(b) of the Securities Act, a rule 482 advertisement is subject to section 12(a)(2) of the Securities Act, which imposes liability for materially false or misleading statements in a prospectus or oral communication, subject to a reasonable care defense.[22] Rule 482 advertisements are also subject to the antifraud provisions of the federal securities laws.[23] Mere compliance with the terms of rule 482 is not a safe harbor against antifraud liability.[24]

Rule 134

In contrast to rule 482, rule 134 is a content-based rule that specifies certain categories of information that a fund may advertise. The Commission adopted rule 134 under the authority of section 2(a)(10)(b) of the Securities Act.[25] Section 2(a)(10)(b) excepts a communication from the definition of ''prospectus'' if the communication states from whom an investor may obtain a written prospectus meeting the requirements of section 10 of the Securities Act and, in addition, does no more than identify the security, state its price and by whom orders will be executed, and contain any other information that the Commission permits by rule. Originally, rule 134 communications, known as ''tombstone advertisements,'' were intended merely to announce the existence of a public offering and serve as a simple means for soliciting inquiries for the statutory prospectus.[26] Over the years, however, the Commission has amended rule 134, broadening the permissible categories of information that a fund may include in its tombstone advertisements.[27] Today, funds may advertise a broad range of information under rule 134, other than performance information.

Because the Commission adopted rule 134 under section 2(a)(10)(b) of the Securities Act, rule 134 advertisements are not considered prospectuses. As a result, rule 134 advertisements do not create liability under section 12(a)(2) of the Securities Act, which by its terms applies only to prospectuses and oral communications.[28] Rule 134 advertisements, however, are subject to the antifraud provisions of the federal securities laws.[29]

Rule 34b–1

Rule 34b–1 under the Investment Company Act applies to supplemental sales literature, *i.e.,* sales literature that is preceded or accompanied by the statutory prospectus.[30] Under rule 34b–1, any performance data included in supplemental sales literature must be accompanied by performance data computed using the standardized formulas for advertising performance under rule 482.[31] The Commission adopted rule 34b–1 to ensure that performance claims in supplemental sales literature would not be misleading and to promote comparability and uniformity among supplemental sales literature and rule 482 advertisements.[32] Supplemental sales literature is subject to the antifraud provisions of the federal

(Sept. 10, 1979)] (''1979 Advertising Adopting Release'') (initially adopting rule 482 as rule 434d).

[19] Rule 482(a)(2) under the Securities Act [17 CFR 230.482(a)(2)]. Business development companies are a category of closed-end investment companies that are not required to register under the Investment Company Act. *See* Section 2(a)(48) of the Investment Company Act [15 U.S.C. 80a–2(a)(48)] (defining ''business development company'').

[20] Investment Company Act Release No. 9811 (June 8, 1977) [42 FR 30379, 30380 (June 14, 1977)] (''1977 Advertising Proposing Release'') (proposing rule 434d, subsequently renumbered as rule 482).

[21] Rule 482 provides mutual funds with an opportunity to advertise, according to standardized formulas, their current yield, tax-equivalent yield, total return, and after-tax return. Mutual funds also may advertise other historical measures of fund performance, subject to certain limitations, provided that the standardized total return is also included. Rule 482(e) under the Securities Act [17 CFR 230.482(e)]. The Commission adopted the use of standardized formulas in order to permit prospective investors to compare the performance claims of competing funds and to prevent misleading performance claims by funds. Investment Company Act Release No. 16245 (Feb. 2, 1988) [53 FR 3868 (Feb. 10, 1988)] (''1988 Advertising Adopting Release'').

[22] 15 U.S.C. 77*l*(a)(2). An action under section 12(a)(2) does not require proof of scienter (*i.e.,* an intent to defraud 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 under the antifraud provisions of section 10(b) of the Securities Exchange Act of 1934 (''Exchange Act'') [15 U.S.C. 78j(b)] reqire proof of scienter and investor reliance. Under either type of claim, however, the plaintiff must establish that the misrepresentation or omission is material.

[23] *See, e.g.,* Section 17(a) of the Securities Act [15 U.S.C. 77q]; section 10(b) of the Exchange Act [15 U.S.C. 78j(b)]; section 34(b) of the Investment Company Act [15 U.S.C. 80a–33]; section 206 of the Investment Advisers Act of 1940 [15 U.S.C. 80b–6] (''Investment Advisers Act'').

Members of the National Association of Securities Dealers, Inc. (''NASD'') also must comply with rule 2210 of the NASD Conduct Rules when sponsoring fund advertisements. Rule 2210 provides NASD members with general standards outlining what may constitute misleading fund advertising and specific standards reflecting requirements for advertising communications. Rules 2210(d)(1) and (2) of the NASD Conduct Rules.

[24] 1988 Advertising Adopting Release, *supra* note 21, at 3878 n. 51. *See also* Investment Company Act Release No. 24832 (Jan. 18, 2001) [66 FR 9002, 9008 (Feb. 5, 2001)] (''After-Tax Adopting Release'') (compliance with rule 482 is not a safe harbor from antifraud liability); Investment Company Act Release No. 15315 (Sept. 17, 1986) [51 FR 34384, 34391 (Sept. 26, 1986)] (''1986 Advertising Proposing Release'') (in proposing amendments to rule 482 to require the inclusion of a legend on advertisements, Commission stated that it was ''not suggesting that the legend information contains all the material information necessary to prevent an ad from being misleading * * *[and] that whoever sponsors the ad, be it the fund, the underwriter, or the dealer, bears the primary responsibility for assuring that the ad is not false or misleading''); 1977 Advertising Proposing Release, *supra* note 20, at 30380 (advertisements made pursuant to rule 434d (subsequently renumbered as rule 482) would be subject to the antifraud provisions of the securities laws); *In the Matter of The Dreyfus Corporation and Michael L. Schonberg,* Investment Advisers Act Release No. 1870 (May 10, 2000) (''Dreyfus Order'') (advertisements that comply with rule 482 are subject to the general antifraud provisions of the securities laws).

[25] 15 U.S.C. 77b(a)(10(b).

[26] *See* Division of Investment Management, Securities and Exchange Commission, Protecting Investors Study: A Half Century of Investment Company Regulation (1992) (''Protecting Investors Study'') at 358. *See also* T. Lemke, G. Lins, A. Smith III, Regulation of Investment Companies, Vol. 1, ch. 14, § 14.02, at 14–3 (2001).

[27] *See* Securities Act Release No. 5250 (May 9, 1972) [37 FR 10071 (May 19, 1972)] (permitting tombstone advertisement to include general description of mutual fund); Investment Company Act Release No. 8568 (Nov. 4, 1974) [39 FR 39868 (Nov. 12, 1974)] (permitting tombstone advertisement to include description of certain special attributes of mutual fund, *e.g.,* discussion of a fund's investment objectives); Investment Company Act Release No. 8824 (June 16, 1975) [40 FR 27442 (June 30, 1975)] (extending the expanded tombstone advertising contents to UITs and permitting certain kinds of pictorial illustrations, such as logos, to be used in investment company tombstone advertising).

[28] *See supra* note 22 and accompanying text (discussing liability under section 12(a)(2) of the Securities Act).

[29] *See supra* note 23 (noting various antifraud provisions under the federal securities laws).

[30] 17 CFR 270.34b–1. Under section 2(a)(10)(a) of the Securities Act [15 U.S.C. 77b(a)(10)(a)], a communication sent or given after the effective date of the registration statement is not deemed a ''prospectus'' if it is proved that prior to or at the same time with such communication a written statutory prospectus was sent or given to the person to whom the communication was made.

[31] Rule 34b–1 applies to supplemental sales literature that is required to be filed with the Commission under section 24(b) of the Investment Company Act [15 U.S.C. 80a–24(b)], *i.e.,* supplemental sales literature of registered open-end companies, unit investment trusts, and face-amount certificate companies.

[32] 1986 Advertising Proposing Release, *supra* note 24, at 34393.

securities laws. Mere compliance with the terms of rule 34b–1 is not a safe harbor against antifraud liability.[33]

Rule 156

Rule 156 under the Securities Act provides guidance on the types of information that could be misleading in fund sales literature.[34] It applies to all advertisements and supplemental sales literature.[35] Under rule 156, whether a statement involving a material fact is misleading depends on an evaluation of the context in which it is made. Rule 156 indicates that representations about past performance could be misleading in situations where portrayals of past performance convey an impression of net investment results that would not be justified under the circumstances.[36]

B. Performance Advertising Practices

Although there are many factors other than performance that an investor should consider in deciding whether to invest in a particular fund, many investors consider performance to be one of the most significant factors when selecting or evaluating mutual funds.[37] Eager to attract new investors, many funds have, from time to time, engaged in advertising campaigns focusing on past performance. As a result of advertising that focused on extraordinary fund performance during 1999–2000, there have been increasing concerns that some funds, when advertising their performance, may resort to techniques that create unrealistic investor expectations or may mislead potential investors.[38] As discussed more fully below, we have particular concerns about the following practices:

- Advertising performance without providing adequate disclosure of unusual circumstances that have contributed to performance;
- Advertising performance without providing adequate disclosure of the performance period, that more current performance information is available, or that more current performance may be lower than advertised performance; and
- Advertising performance based on selective dates or time periods in order to showcase fund performance as of those specific dates or time periods without providing disclosure that would permit an investor to evaluate the significance of the performance.

Unusual Circumstances That Contribute to Fund Performance

Mutual fund performance advertisements may be materially misleading when they fail to adequately disclose that unusual circumstances contributed to the fund's advertised performance. In each of two enforcement actions, an investment adviser had marketed a relatively small fund's unusually high return without disclosing that a significant percentage of the fund's return was attributable to its investments in securities issued in initial public offerings.[39] Given the substantial growth in the funds' assets as a result of sales of the funds' shares to the public, to the point where the funds were no longer experiencing, by investing in additional initial public offerings, substantially similar performance as they previously experienced, the Commission found that the failure to disclose the contribution to the funds' performance of the initial public offering investments was materially misleading.

To address these concerns, some mutual fund advertisements supplement their presentations of performance information with narrative disclosure that is designed to inform investors that the funds' performance was achieved through the use of particular investment strategies under specified circumstances that are not likely to recur. For example, one fund advertisement disclosed that a significant portion of the fund's advertised performance was attributable to the allocation of initial public offering securities to the fund but indicated that such allocation would not likely continue in the future.

Currentness of Performance Information

Rule 482 requires all performance data contained in any mutual fund advertisement to be as of the most recent practicable date, provided that any advertisement containing total return quotations is considered to have complied with this requirement if the total return quotations are current to the most recent calendar quarter ended prior to submission of the advertisement for publication.[40] As a result, total return quotations may be up to three months old at the time that an advertisement is submitted for publication. We are concerned that, in some cases, an advertisement that complies with these requirements of rule 482 may nonetheless confuse, or even mislead, investors regarding the fund's current performance, particularly when the fund's performance has declined significantly after the period reflected in an advertisement.

We questioned this practice in an enforcement action where we found that the failure to disclose the large impact of initial public offerings on a fund's performance during the fund's first fiscal year made the fund's performance advertisements materially false and misleading.[41] One of the significant facts in that case was that the fund's advertisements publicized extraordinary first-year returns at a time when the fund's more current returns had become negative.[42] While the fund advertisements complied with rule 482, we noted that rule 482 advertisements remain ''subject to the general antifraud

[33] After-Tax Adopting Release, *supra* note 24, at 9008.

[34] 17 CFR 230.156.

[35] 17 CFR 230.156(c).

[36] 17 CFR 230.156(b)(2)(i). *See* Investment Company Act Release No. 10915 (Oct. 26, 1979) [44 FR 64070 (Nov. 6, 1979)] (adopting rule 156).

[37] *See* Investment Company Institute, *Understanding Shareholders' Use of Information and Advisers* (Spring 1997), at 21 and 24 (Total return information was frequently considered by investors before a purchase, second only to the level of risk of the fund. Eighty-eight percent of fund investors surveyed said that they considered total return before their most recent purchase of a mutual fund. Eighty percent of fund owners surveyed reported that they followed a fund's rate of return at least four times per year.). *See also* Securities and Exchange Commission, *Mutual Fund Investing: Look at More Than a Fund's Past Performance, supra* note 10 (cautioning investors to consider factors other than performance, such as fees, risks, volatility, and recent changes in the fund's operations, when evaluating mutual funds).

[38] Paul F. Roye, Director, Division of Investment Management, ''Success and Survival of the Mutual Fund Industry in a Changing World,'' Remarks before the ICI General Membership Meeting, Washington, DC (May 19, 2000) (discussing Commission concerns with fund advertising). (transcript available at http://www.sec.gov/news/speech/spch373.htm).

See also NASD Regulation, Inc. (''NASDR''), *Inaccurate Performance Graphs Result In Formal Action* (last modified Summer 2000) http://www.nasdr.com/rca_summer00_adv.htm (warning against misleading performance graphs in fund advertising); NASD Notice to Membes No. 00–21 (Apr. 2000) (''NASD Notice 00–21'') (advising members to be careful when advertising extraordinary fund performance because prospective investors may believe that these unusually high returns will continue and warning that material disclosures, which may balance an advertisement's overall message, should not be relegated to footnotes).

[39] Dreyfus Order, *supra* note 24 (investment adviser violated antifraud prohibitions of section 206(2) of the Investment Advisers Act [15 U.S.C. 80b–6(2)] and section 17(a)(3) of the Securities Act [15 U.S.C. 77q(a)(3)]); *In the Matter of Van Kampen Investment Advisory Corp. and Alan Sachtleben,* Investment Advisers Act Release No. 1819 (Sept. 8, 1999) (investment adviser violated antifraud prohibitions of section 206(2) of the Investment Advisers Act [15 U.S.C. 80b–6(2)] and section 34(b) of the Investment Company Act [15 U.S.C. 80a–33(b)]).

[40] Rule 482(g) under the Securities Act [17 CFR 230.482(g)].

[41] *See* Dreyfus Order, *supra* note 24.

[42] *Id.* (81.92% total return for the one-year period ended September 30, 1996, publicized in October through December 1996 when total returns for the three-month periods ended August 30, September 30, October 31, November 29, and December 31, 1996, were negative 17.03%, 7.71%, 7.79%, 16.25%, and 13.37%, respectively).

provisions of the federal securities laws and must not be false and misleading.''[43]

To address this concern, some mutual fund advertisements supplement their presentations of performance information with narrative disclosure that is designed to inform investors that the advertised performance is not the fund's current performance. Some advertisements disclose that, due to market volatility or other factors, the fund's performance changes over time or that the fund's current performance may be lower than the advertised performance. Other advertisements direct investors to other sources where they may find more up-to-date performance information, such as the fund's toll-free telephone number or website or the mutual fund section of the newspaper in which the advertisements appear. In addition, some advertisements include performance information that is more current than the information required by rule 482.

Selective Use of Performance Figures

A mutual fund advertisement may be materially misleading when it showcases a fund's performance for a certain time period without providing sufficient information to permit an investor to evaluate the significance of the performance data. Rule 482, by its terms, permits a mutual fund to advertise its performance for any period so long as it is accompanied by performance for 1-, 5-, and 10-year periods (or, if shorter, for the life of the fund) current to the most recent quarter.[44] Nonetheless, if a fund selectively advertises performance that is unusually high and not representative of the fund's historical performance, investors potentially may be misled. Selectively advertising performance as of a particular date may be particularly problematic where performance has declined after the chosen date but before the advertisement is submitted for publication. To address these concerns, some mutual fund advertisements supplement their performance presentations with narrative disclosure to the effect that the fund's performance may be volatile, that the performance information shown is not current, or that the advertised performance is not representative of the fund's historical performance.

II. Discussion

We are proposing to amend rule 482 to permit rule 482 advertisements to include information that is not included in the statutory prospectus, in accordance with NSMIA. In light of the proposed amendments to rule 482, we are also proposing to rescind the provisions in rule 134 that apply to funds. At the same time, however, and in light of our concerns about fund advertising practices, we believe that it is appropriate to reinforce the antifraud protections in the fund advertising rules. Our proposals would require enhanced disclosure of information in fund advertisements and are designed to encourage advertisements that convey balanced information to prospective investors.

A. Eliminating the ''Substance of Which'' Requirement From Rule 482 and Rescinding Rule 134 for Funds

In 1992, the Division of Investment Management recommended to the Commission that the Securities Act be amended to permit investment companies to advertise a wide range of information in the form of an ''advertising prospectus,'' including information that is not included in the statutory prospectus required by section 10(a).[45] Congress embraced this recommendation in NSMIA when it added new section 24(g) to the Investment Company Act. Section 24(g) directs the Commission to adopt rules or regulations that permit registered investment companies to use prospectuses that (i) include information the substance of which is not included in the statutory prospectus, and (ii) are deemed to be permitted by section 10(b) of the Securities Act.[46]

Today we are proposing to implement this provision of NSMIA by amending rule 482 to remove the requirement that a rule 482 advertisement contain only information the ''substance of which'' is included in the statutory prospectus.[47] Eliminating this requirement will permit investment companies to include more information in rule 482 advertisements on a real-time basis, *e.g.*, information about current economic conditions that normally would not be included in a fund's prospectus. The proposed amendment will also permit funds to eliminate from the statutory prospectus information, such as boilerplate disclosure about the methods used to calculate performance in fund advertising, that clutters the statutory prospectus and obscures other important information. As a result, investors should receive better, more understandable, and more timely information in both the statutory prospectus and fund advertisements. In addition, the costs of regulatory compliance will be reduced for funds and, ultimately, for investors.

Elimination of the ''substance of which'' requirement from rule 482 should not diminish investor protection. The ''substance of which'' requirement is a technical requirement that does not, in itself, prevent misleading statements because it does not require an advertisement to use the same words as the statutory prospectus or prohibit the use of advertising techniques that are not included in the statutory prospectus.[48] Importantly, rule 482 advertisements, as ''prospectuses,'' will remain subject to section 12(a)(2) liability and the antifraud provisions of the federal securities laws. Also, rule 482 advertisements, as section 10(b) prospectuses under the Securities Act, are subject to the summary suspension provisions of section 10(b), which permit the Commission to suspend the use of a materially false or misleading prospectus.[49] In addition, fund advertising materials must continue to be filed with NASD Regulation, Inc. (''NASDR'') or the Commission, and NASDR rules relating to fund advertising will continue to apply.[50]

---

[43] *Id.* at n. 16. Similarly, NASDR warned its members about performance advertising when a security's performance has been negatively affected by sudden changes in market conditions. NASDR advised its members ''that if a security experiences an abrupt negative change in performance, member firms should amend their historical performance communications to add either updated performance figures or clear disclosure that current performance is less than the figures shown.'' NASD Regulation, Inc., *Sudden Performance Changes May Require More Information* (last modified Summer 1999) http://www.nasdr.com/3085_9906. htm.

[44] Rule 482(e)(5)(ii) [17 CFR 230.482(e)(5)(ii)].

[45] Protecting Investors Study, *supra* note, at 370.

[46] 15 U.S.C. 80a–24(g). *See also* S. REP. NO. 293, 104th Cong., 2d Sess. 8 (1996) (stating that the ''bill improves fund advertising by giving the Commission express authority to create a new investment company 'advertising prospectus' '').

[47] The ''substance of which'' requirement is presently contained in rule 482(a)(2) [17 CFR 230.482(a)(2)]. We are also proposing to revise the language in the current note to paragraph (a)(3) of rule 482, which states that ''[t]he 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.'' The proposed removal of the ''substance of which'' requirement makes the reference to the section 10(a) prospectus unnecessary. The revised language of this note is incorporated into the proposed note to proposed paragraph (a) of rule 482. *See* Section II.B., *infra*, ''Applicability of Antifraud Provisions to Fund Advertising.''

[48] *See* 1977 Advertising Proposing Release, *supra* note 20, at 30380.

[49] 15 U.S.C. 77j(b).

[50] Section 24(b) of the Investment Company Act [15 U.S.C. 80a–24(b)] requires the filing with the Commission of ''any advertisement, pamphlet, circular, form letter, or other sales literature'' for any registered investment company other than a closed-end fund. Rule 24b–3 under the Investment

Finally, we are today proposing additional amendments to rule 482 to reinforce antifraud protections, particularly in the area of fund performance.[51]

We are using our exemptive authority under the Securities Act to eliminate the ''substance of which'' requirement from rule 482 for the securities of business development companies (''BDCs'') as well as registered investment companies.[52] Currently, BDCs and registered investment companies are treated similarly under rule 482. We believe that it is appropriate to extend the benefits that would result from elimination of the ''substance of which'' requirement to BDCs, given that elimination of this requirement should not diminish investor protection. We note, however, that BDCs, unlike mutual funds, do not continuously offer and sell their shares and do not make extensive use of advertisements.

We request comment on the elimination of the ''substance of which'' requirement from rule 482.

- Are the proposed amendments to rule 482 to eliminate the ''substance of which'' requirement the appropriate means for implementing the authority provided to the Commission in NSMIA?
- Are other restrictions or conditions necessary in rule 482 for the protection of investors in the absence of the ''substance of which'' requirement?
- What concerns should be addressed by any such restrictions or conditions?
- Should the ''substance of which'' requirement be eliminated for BDCs?

With the proposed elimination of the ''substance of which'' requirement, we believe that funds will no longer need to rely on rule 134.[53] We are therefore proposing to remove the provisions of rule 134 that apply specifically to funds and to exclude both registered investment companies and business development companies from relying on rule 134. Rule 134 will remain available to other issuers. Rule 482, as we propose to amend it, will provide funds with sufficient flexibility to discuss topics, such as current economic conditions, that are currently discussed in rule 134 advertisements but generally not in the statutory prospectus. We believe that investor protection will be increased if fund advertisements including this information are subject to rule 482 and, as a result, to section 12(a)(2) liability.[54]

We request comment on the elimination of the rule 134 provisions that apply to funds.

- Should funds be excluded from relying on rule 134?
- If funds should continue to be permitted to rely on rule 134, how, if at all, should rule 134 be amended?
- In the alternative, should only certain types of funds (*e.g.,* closed-end funds or business development companies) be able to use rule 134 advertisements? If so, why?

B. Applicability of Antifraud Provisions to Fund Advertising

The Commission proposes to amend the fund advertising rules in order to reemphasize that fund advertisements are subject to the antifraud provisions of the federal securities laws. We understand that questions have been raised regarding whether compliance with the terms of rule 482 satisfies all of the obligations of a fund with respect to its advertisements.[55] When we initially proposed rule 482 in 1977, we indicated that rule 482 advertisements would be subject to section 12(a)(2) of the Securities Act and the antifraud provisions of the federal securities laws.[56] Since then, we have reiterated that compliance with the ''four corners'' of rule 482 does not alter the fact that funds, underwriters, and dealers are subject to the antifraud provisions of the federal securities laws with respect to fund advertisements.[57]

To emphasize this principle, we propose adding a note to proposed paragraph (a) of rule 482 that would state that an advertisement that complies with rule 482 does not relieve the fund, underwriter, or dealer of the obligation to ensure that the advertisement is not false or misleading. We also propose adding a similar note to the introductory paragraph of rule 34b–1 under the Investment Company Act with respect to supplemental sales literature. We are proposing to add the note to rule 34b–1 to make clear that, as with rule 482, compliance with the rule does not relieve the fund, or its underwriter or dealer, from the obligation to ensure that an advertisement is not false or misleading, whether due to an affirmative misstatement or omission. These proposed notes also would cross-reference rule 156 under the Securities Act, which provides guidance about the factors to be weighed in determining whether statements, representations, illustrations, and descriptions contained in fund advertisements and sales literature are misleading.

In addition, we are proposing to amend rule 156 to provide further guidance regarding the factors to be weighed in considering whether a statement involving a material fact in investment company sales materials is or might be misleading. As discussed above, we are concerned that the advertisement of past performance without an adequate explanation of other facts may create unrealistic investor expectations or even mislead potential investors. For that reason, we are modifying the language of rule 156 to state more explicitly that portrayals of past income, gain, or growth of assets may be misleading where the portrayals omit explanations, qualifications, limitations, or other statements necessary or appropriate to make these portrayals of past performance not misleading.[58] This language is intended to address our concerns with fund performance advertisements that do not provide adequate disclosure (i) of unusual circumstances that have contributed to fund performance;[59] (ii) that more current performance may be lower than advertised performance;[60] or

Company Act [17 CFR 270.24b–3] relieves funds of the obligation to file advertisements and other sales materials with the Commission if that material is filed with NASDR. *See supra* note 23 (discussion of NASD advertising rules).

[51] See discussion in Section II.B., ''Applicability of Antifraud Provisions to Fund Advertising,'' and Section II.C., ''Enhanced Disclosure under Rule 482,'' *infra.*

[52] Section 28 of the Securities Act [15 U.S.C. 77z–3]. Business development companies are a category of closed-end investment companies that are not required to register under the Investment Company Act. *See* Section 2(a)(48) of the Investment Company Act [15 U.S.C. 80a–2(a)(48)] (defining ''business development company'').

[53] The Protecting Investors Study recommended rescinding the provisions of rule 134 applicable solely to funds. Protecting Investors Study, *supra* note 26, at 363.

[54] Rule 134 advertisements are subject to the antifraud provisions under the federal securities laws but do not create liability under section 12(a)(2) of the Securities Act. *See supra* note 22 and accompanying text (discussing section 12(a)(2) liability) and note 28 and accompanying text (discussing rule 134 advertisements and section 12(a)(2)).

[55] *See, e.g.*, Bloomberg News, *SEC Reviewing Funds Ads That May Mislead*, Los Angeles Times, July 13, 1999, at C5 (stating that the Commission's position that advertisements complying with the four corners of rule 482 may still be misleading under the federal securities laws ''has drawn criticism from the fund sector'').

[56] 1977 Advertising Proposing Release, *supra note* 20, at 30380.

[57] 1988 Advertising Adopting Release, *supra* note 21 at 3878 n. 51. See also discussion in note 24, *supra.*

[58] Proposed rule 156(b)(2)(i). Currently, rule 156 states that portrayals of past performance may be deemed misleading if they convey an impression about the investment results that would not be justified under the circumstances. Rule 156(b)(2)(i) under the Securities Act [17 CFR 230.156(b)(2)(i)].

[59] *See supra* 39 note and accompanying text (discussing Commission enforcement cases sanctioning fund advisers for lack of disclosure regarding the impact of investments in initial public offerings on advertised performance).

[60] *See supra* notes 40–43 and accompanying text (discussing concerns that advertisements that comply with rule 482 may nonetheless mislead investors regarding the fund's current performance).

(iii) that would permit an investor to evaluate the significance of performance that is based on selective dates.[61] We remind funds and their underwriters and dealers, however, that this language would address other circumstances that we have not specifically enumerated and that each fund, and its underwriters and dealers, is responsible for analyzing the facts and circumstances concerning its advertisements and determining whether its advertisements may be fraudulent.

We request comment on the proposed amendments reemphasizing the applicability of the antifraud provisions.

• Are there additional amendments to rule 482, rule 34b–1, and rule 156 that would help to emphasize the obligations under the antifraud provisions of funds and their underwriters and dealers?

C. Enhanced Disclosure Under Rule 482

We are also proposing additional amendments to rule 482 that would require enhanced disclosure of certain information designed to encourage advertisements that convey balanced information to prospective investors. Our proposed amendments would require that funds that advertise performance information make available to investors total returns that are current to the most recent month-end. They also would require that fund advertisements include improved narrative information and present explanatory information more prominently.

Availability of Month-End Performance Information

As discussed above, Rule 482 requires all performance data contained in any mutual fund advertisement to be as of the most recent practicable date, provided that any advertisement containing total return quotations is considered to have complied with the requirement if the total return quotations are current to the most recent calendar quarter ended prior to submission of the advertisement for publication.[62] As a result, total return quotations may be up to three months old at the time that an advertisement is submitted for publication. We are concerned that, in some cases, an advertisement that complies with these requirements of rule 482 may nonetheless confuse, or even mislead, investors, particularly when performance has declined significantly after the period reflected in an advertisement.

In order to address this concern, we are proposing to add a second condition for a fund advertisement to be considered to have complied with the requirement of rule 482 that performance be as of the most recent practicable date. Specifically, total return quotations current to the most recent month-end, and available to investors within three calendar days of the most recent month-end, must be provided at a toll-free (or collect) telephone number.[63]

This proposal would ensure that investors who are provided advertisements touting a fund's performance will have ready access to performance that is current to the most recent month-end and will not be forced to rely on performance data that may be more than three months old at the time of use by the investor. Outdated fund performance that is relied on by an investor when, for example, the markets have generally entered a period of lower performance, may cause the investor to have an overly optimistic view of the fund's ability to outperform the markets. We believe that today's proposal will help to address this problem by making more recent performance data available to investors in any fund that advertises its performance.

We note that the proposed amendments would require the availability of month-end performance information even if the advertisement itself included performance current as of the most recent month-end at the time of submission for publication. The availability of month-end information would be useful to investors in these circumstances if, for example, the advertisement continued to be used subsequent to the end of the following month, or if the investor referred to the advertisement at a later date.

Finally, we note that the availability of month-end information by telephone does not alter the application of the antifraud provisions to an advertisement. The month-end information obtained through a telephone call would not be considered part of the advertisement itself.

We considered amending the requirements of rule 482 to provide that an advertisement would be considered to have complied with the ''most recent practicable date'' requirement if the total return quotations are current to the most recent calendar month ended prior to submission of the advertisement for publication. This approach would have the advantage of providing more current performance information to investors in advertisements rather than placing the burden on investors to seek out this information through a telephone call. We were not, however, persuaded that the benefits to investors from this approach would outweigh the costs it would impose.

First, a month-end standard for rule 482 performance data could result in an increase in the number of instances in which performance information for different periods appeared concurrently as a result of different lead times for different publications. One advantage of the quarter-end approach is that it tends to result in the publication of comparable numbers by different funds. Second, requiring all funds to publish data as of the most recent month-end in all cases, without regard to the materiality of this information, would perhaps accord very recent performance greater status than it deserves and could contribute to investors' tendency to focus excessively on short-term performance.[64]

A month-end standard would also impose costs on funds and, indirectly, on investors. While a month-end standard might be fairly simple to comply with for advertisements in some publications (*e.g.,* newspapers), it might be difficult for other forms of advertisement. For example, mutual fund distributors frequently supply sales material in bulk to third-party intermediaries, such as broker-dealers, and to retirement plan sponsors, who then distribute it to investors. If month-end numbers were required, the ''shelf life'' of this material would be abbreviated, which could result in significant additional printing and compliance costs associated with preparing updated material and providing it to all distribution channels.

We also considered whether to provide funds greater flexibility in determining the medium through which to make month-end numbers available, so that a fund could, for example, meet this obligation through website access. We concluded that, at this time, requiring telephone availability would ensure the most widespread access to this information by all investors. While the percentage of households with Internet access has increased considerably in recent years, it remains

[61] *See supra* 44 note and accompanying text (discussing concerns about selective advertisement of performance that is unusually high and not representative of a fund's historical performance).

[62] Rule 482(g) under the Securities Act [17 CFR 230.482(g)].

[63] Proposed paragraph (g)(2) of rule 482. Our understanding is that funds typically calculate performance daily so that making month-end performance numbers available within three calendar days of the most recent month-end should not be burdensome.

[64] *See* Securities and Exchange Commission, *Mutual Fund Investing: Look at More Than a Fund's Past Performance, supra* note (cautioning investors to look beyond short-term performance records).

substantially lower than the percentage with access to telephones.[65] We note, however, that we have taken steps to encourage issuers and market intermediaries to communicate with and deliver information to investors through the Internet.[66] The increased availability of information through this medium has helped to promote transparency, liquidity, and efficiency by making information available to investors quickly and in a cost-effective manner. We encourage each fund to make its month-end performance information available to its investors on its website, if it has one. We applaud the efforts already being made by many funds to provide access to performance and other information, such as prospectuses, cost information, and portfolio holdings, through their websites. We encourage other funds to make similar efforts.

We also note that nothing in rule 482 or our proposed amendments would preclude a fund from using (and disclosing in a rule 482 advertisement) other methods for providing updated performance information, such as broker-dealers, investment advisers, and other financial intermediaries. We would encourage funds to use any means to make this information more accessible. Our proposals reflect our view, however, that updated performance information should be available from the fund itself through a telephone call to an identified number and that other forms of distribution of this updated information should supplement availability from the fund itself.

We request comment on the proposed requirement that funds make available month-end performance numbers through a toll-free (or collect) telephone number in order to comply with the currentness requirements of rule 482.

- Is our proposed requirement appropriate, or should we, instead, require funds to provide more current performance information in all advertisements? If so, how current should the information be, *e.g.,* month-end, week-end, or some other period?
- Should we require funds to provide more current performance information in certain types of publications, *e.g.,* websites or newspapers and other publications where there is a short lead time between submission and publication and a short shelf life? If so, how current should the performance information be, *e.g.,* month-end, week-end, or some other period? To what types of publications should this requirement apply?
- If we require funds to provide more current performance information through a toll-free telephone number or other means, is month-end data current enough or should this information be updated more frequently than monthly (*e.g.,* weekly or daily)?
- Should we require month-end performance data to be available at a toll-free (or collect) telephone number where the advertisement itself includes performance data current to the most recent month ended prior to submission of the advertisement for publication?
- Should we require that updated performance information available through a telephone number be current as of the most recent practicable date (rather than specifying a particular date, such as month-end), and, if so, should we provide guidance regarding what would satisfy that requirement (*e.g.,* month-end data)?
- Is three calendar days an appropriate period of time after each month-end in which to require funds to make available month-end performance information on a telephone line? If not, should funds be allowed more or less time, and, if so, how much time is needed, *e.g.,* 1 day, 5 days, or some other amount of time? Should the time period be based on calendar days or business days?
- Is telephone access to updated performance information the best alternative, or is another alternative, such as website access, better?
- Should funds have flexibility to choose the medium for communicating updated performance information?
- What would be the cost of requiring access to month-end performance information by toll-free telephone number for funds that do not currently provide this access?
- A number of daily newspapers of national circulation, such as *The Wall Street Journal* and *The New York Times,* publish returns for a significant number of mutual funds on a daily basis.[67] Should funds that advertise performance information, and for which daily performance information is available in the press, be required to refer to the availability of the daily information in their performance advertisements?

Improved Narrative Disclosure

As discussed above, there have been increasing concerns, arising from the period of extraordinary market performance in 1999 and 2000, that some funds, when advertising their performance, may resort to techniques that create unrealistic investor expectations or may mislead potential investors. As a result, we are proposing changes to the narrative disclosure that is required to accompany performance advertisements in order to help investors understand the limitations of past performance data and enhance the ability of investors to obtain updated performance information. At present, rule 482 requires advertisements to disclose (i) a source from which an investor may obtain a prospectus containing more complete information about the fund; (ii) that the performance data quoted represents past performance; and (iii) in the case of a non-money market fund, that the investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost.[68] Our proposed amendments would also require funds to include the following information in rule 482 advertisements that contain performance figures: (i) A statement that past performance does not guarantee future results; (ii) a statement that current performance may be lower or higher than the performance data quoted; and (iii) a fund toll-free (or collect) telephone number and, if available, a Web site where an investor

[65] Economics and Statistics Administration & National Telecommunications and Information Administration, *A Nation Online: How Americans Are Expanding Their Use of the Internet,* at 3 (Feb. 2002) (50.5% of households had Internet access as of Sept. 2001); Federal Communications Commission, *Telephone Subscribership In the United States,* at 1 (Feb. 2002) (95.1% of households had telephone service as of July 2001).

[66] *See, e.g.,* Securities Act Release No. 8089 (April 12, 2002) [67 FR 19896, 19902 (April 23, 2002)] (proposing to require companies to include disclosure in their annual reports on Form 10–K about the availability on company websites of reports on Forms 10–K, 10–Q, and 8–K).

[67] *See* NASD Manual § 6800 (CCH) at 6551 (March 2001) (describing Mutual Fund Quotation Service which disseminates prices for mutual funds). A mutual fund may choose to be included in the news media list released by The NASDAQ Stock Market through the Mutual Fund Quotation Service if it has at least 1,000 shareholders or $25 million in net assets. *Id.* at § 6800(c)(1)(A).

[68] Rule 482(a)(3)(i) and (6) [17 CFR 230.482(a)(3)(i) and (6)]. Rule 482(a)(3)(ii) [17 CFR 230.482(a)(3)(ii)] requires that an advertisement used with a profile under rule 498 under the Securities Act [17 CFR 230.498] indicate that information is available in the profile about the fund, the procedures for investing in the fund, and the availability of the fund's prospectus. In addition, rule 482(a)(4) requires the ''subject to completion'' legend required by rule 481(b)(2) under the Securities Act if the advertisement is used prior to effectiveness of the fund's registration statement, or, in the case of a registration statement that becomes effective omitting certain information from the prospectus contained in the registration statement in reliance upon rule 430A, when the advertisement is used prior to determination of the public offering price. Rule 481(b)(2); rule 430A [17 CFR 430.481(b)(2); 430.430A].

may obtain performance data current to the most recent month-end.[69]

These statements should help investors to understand the limitations of past performance presentations, namely, that they represent historical information that may not repeat in the future and may even be somewhat outdated at the time an investor is reviewing them. In addition, provision of a toll-free (or collect) telephone number and, if the fund has month-end performance information available on its Web site, the Web site where an investor may obtain performance data current to the most recent month-end will provide investors ready access to a fund's more current performance.

We are also proposing an amendment to rule 482 that would direct prospective investors' attention to a fund's charges and expenses. The proposed amendment would require a fund to note in its rule 482 advertisements that information about charges and expenses is contained in the statutory prospectus.[70] The many fund advertisements highlighting fund performance have focused investor attention on fund returns.[71] Investors, however, may be overlooking other important fund features, particularly charges and expenses, that may diminish a fund's return.[72]

Mutual fund fees and expenses are extremely important to shareholders. The United States General Accounting Office (''GAO''), in a recent report to Congress on mutual fund fees, stressed the importance of heightening ''investors'' awareness and understanding of the fees they pay.''[73] We believe that the amendment we are proposing today, which will ensure that fund advertisements remind fund shareholders about the availability of information about fund charges and expenses, will help to address the GAO's concerns. Although rule 482 already requires that fund advertisements that contain performance data include standardized performance information net of fees and charges,[74] we agree with the GAO that the level of charges and expenses of a mutual fund is an independent factor that should be given serious consideration by a mutual fund investor.

We request comment on the proposed requirement for disclosure about charges and expenses.

- Will the proposed disclosure about charges and expenses be helpful to investors?
- Is there other disclosure with respect to charges and expenses that should be required in fund advertisements? Are there fund features, in addition to charges and expenses, that a rule 482 advertisement should highlight?

Presentation of Explanatory Information

We are also proposing that funds present certain information in their rule 482 advertisements more prominently. Funds often present required disclosure in small print and relegate it to a footnote at the bottom of a print advertisement or the end of a television advertisement.[75] At present, rule 482 requires that the statement regarding the availability of the prospectus be ''conspicuous'' and that quotations of standardized performance be given no less prominence than other performance quotations.[76] In addition, rule 482 print advertisements are required by rule 420(a) under the Securities Act to be in roman type at least as large and as legible as 8-point modern type.[77] Under rule 420(b), rule 482 advertisements distributed through an electronic medium may satisfy legibility requirements applicable to printed documents by presenting all required information in a format readily communicated to investors, and, where indicated, in a manner reasonably calculated to draw investor attention to specific information.[78]

The proposed amendments would require print advertisements to present required narrative disclosures in a size type at least as large as and of a style different from, but at least as prominent as, that used in the major portion of the advertisement.[79] This requirement would apply to the required narrative disclosures about the prospectus and the performance data.[80] A radio or television advertisement would be required to give the required narrative disclosures emphasis equal to that used

---

[69] Proposed paragraph (b)(3)(i) of rule 482. *Cf.* NASD Conduct Rule 2210(d)(2)(N) (investment performance illustrations may not imply that gain or income realized in the past will be repeated in the future); NASD Conduct Rule IM–2210–3(c)(4) (all advertisements and sales literature containing an investment company ranking must disclose that past performance is no guarantee of future results).

[70] Proposed paragraph (b)(1)(i) of rule 482. This disclosure would also be required in an advertisement used with a profile pursuant to rule 498 under the Securities Act. Proposed paragraph (b)(1)(ii) of rule 482. Rule 482 currently does not require funds to highlight the availability of information regarding the fund's charges and expenses. The rule does, however, require an advertisement to identify a source from which an investor may obtain a prospectus containing more complete information about the fund. Rule 482(a)(3)(i) [17 CFR 230.482(a)(3)(i)]. The rule also requires that a fund that advertises performance data include some information about sales loads and other nonrecurring fees. Rule 482(a)(6) [17 CFR 230.482(a)(6)].

[71] *See supra* note 37 and accompanying text (discussing concerns about advertising campaigns focused on past performance).

[72] *See* Securities and Exchange Commission, *Mutual Fund Investing: Look at More Than a Fund's Past Performance, supra* note 37 (cautioning investors to look beyond performance when evaluating funds and to consider the costs relating to a fund investment). *See also* NASD Notice to Members No. 98–107 (1998) (reminding members of their obligation to ensure that discussions concerning fees and expenses in fund advertising are fair, balanced, and not misleading).

[73] United States General Accounting Office, *Mutual Fund Fees: Additional Disclosure Could Encourage Price Competition* at 97 (June 2000).

[74] Rule 482 requires that funds base standardized performance calculations on the methods prescribed in Forms N–1A, N–3, or N–4. Rule 482(d)(1), (e)(1)(i), (e)(2)(i), (e)(3)(i), and (e)(4)(i) [17 CFR 230.482(d)(1), (e)(1)(i), (e)(2)(i), (e)(3)(i), and (e)(4)(i)]. These forms generally require the deduction of all recurring fees and maximum sales loads and charges deducted from payments in calculating standardized performance. Item 21(b)(1), (2), and (3) of Form N–1A; Item 25(b)(i) of Form N–3; Item 21(b)(i) of Form N–4.

[75] *See* Adam Shell, Investors' Business Daily, Feb. 3, 2000, at B1 (stating that the placement of serious warnings in ''mice type'' is a disservice to investors); Cruz, *supra* note 8 (stating that fund advertising often prints extraordinary fund return in bold-faced type but then discloses risk factor language in ''the fine print at the bottom of the ad''); Marcy Gordon, *Securities Regulators Look at Mutual Fund Sales Pitches,* The Austin American-Statesman, Feb. 18, 2000, at D2 (citing how the Commission has decried the ''recent proliferation of ads by mutual fund companies boasting of triple-digit returns * * * [when] only the fine print in the ads explains why the performance was so strong''). *Cf.* In the Matter of LBS Capital Management, Inc., Investment Advisers Act Release No. 1644 (Jul. 18, 1997) (disclosure in footnote that advertised results of investment adviser were ''pro forma'' was inadequate to dispel misleading suggestion that advertised performance represented results of actual trading).

[76] Rule 482(a)(3), (e)(1)(iii), (e)(2)(iii), (e)(3)(iii), (e)(4)(v), and (e)(5)(iv) [17 CFR 230.482(a)(3), (e)(1)(iii), (e)(2)(iii), (e)(3)(iii), (e)(4)(v), and (e)(5)(iv)].

[77] Rule 420(a) [17 CFR 230.420(a)].

[78] Rule 420(b) [17 CFR 230.420(b)]. These legibility requirements include paper size, type size and font, bold-face type, italics, and red ink.

[79] Proposed paragraph (b)(5) of rule 482. The proposed presentation requirements for rule 482 are the same as those currently required under rule 134. Rule 134(a)(iii) [17 CFR 230.134(a)(iii)]. The proposed presentation requirements would replace the current rule 482 requirement that certain required disclosures be ''conspicuous.'' Rule 482(a)(3) [17 CFR 230.482(a)(3)].

In addition to complying with the presentation requirements of proposed paragraph (b)(5) of rule 482, electronic versions of print rule 482 advertisements would also continue to be subject to the legibility requirements of rule 420(b). [17 CFR 230.420(b)].

[80] Proposed paragraphs (b)(1) and (b)(3) of rule 482. The narrative disclosure covered by the prominence requirement would also include, if applicable, the ''subject to completion'' legend that would be required by proposed rule 482(b)(2), and, if the advertisement is used with a profile under rule 498 under the Securities Act [17 CFR 230.498], disclosure explaining that the profile contains information about the fund, describing the procedures for investing in the fund, and indicating the availability of the prospectus. Proposed paragraphs (b)(1)(ii) and (b)(2) of rule 482. In addition, the prominence requirement would extend to disclosures specific to money market funds. Proposed paragraph (b)(4) of rule 482.

in the major portion of the advertisement.[81] These prominence requirements are intended to prevent advertisements from marginalizing or minimizing the presentation of the required disclosure.

In addition, we are proposing that the narrative disclosures that specifically relate to fund performance be presented in close proximity to the performance data in both print and radio and television advertisements.[82] In a print advertisement, this information also would be required to be in the body of the advertisement and not in a footnote. Rule 482 currently requires that performance advertisements identify the dates during which quoted performance occurred.[83] We propose to require this information to be adjacent to, and have no less prominence than, the performance quotation itself.[84] These proximity requirements are intended to help investors more readily find information and disclosure necessary to understand and evaluate the performance data shown, and to remind investors of the limitations of performance data.

We solicit comment on the proposed presentation requirements.

- Are the proposed presentation requirements appropriate to encourage important explanatory information to be given sufficient prominence?
- Are there alternative methods for encouraging important explanatory information to be given sufficient prominence in a rule 482 advertisement?
- Which required disclosures should be covered by any such presentation requirements?
- Should we require a font size larger than the 8-point type required under rule 420 for these required disclosures?
- Are the proposed presentation requirements feasible for radio and television advertisements, given the inherent time limitations associated with the use of these media?
- Are there specific presentation requirements that should apply to the use of electronic media?
- Are there any other requirements that should apply to fund performance advertisements in order to help ensure that performance is presented in a manner that is accurate, balanced, and not misleading?

D. Reorganization of Rule 482 and Technical Form Amendments

We also propose to reorganize rule 482 to make it easier to use. To do this, we have added headings to the rule and have simplified certain provisions, without changing their content, to make the rule easier to understand. In addition, we have reordered provisions within the rule and grouped the provisions by topic.

We request comment on the reorganization of rule 482.

- Would these proposed changes make the rule more comprehensible?
- Are there other changes that would be helpful?
- Would these amendments inadvertently change the meaning of any provisions within the rule?

We also propose to amend Item 21 of Form N–1A, Item 25 of Form N–3, and Item 21 of Form N–4, and to delete Item 4(c) of Form N–3, Item 4(b) of Form N–4, and Item 25 of Form N–6 to reflect the proposed removal of the ''substance of which'' requirement in rule 482.[85] These items require funds that advertise performance data to provide in their prospectuses or statements of additional information (''SAI'') certain explanatory disclosure about the methods by which the performance data is calculated.[86] This information is included in the prospectus or SAI to satisfy the ''substance of which'' requirement in connection with performance advertising.[87] The proposed removal of the ''substance of which'' requirement renders this disclosure unnecessary. As a result, we are revising these items in Forms N–1A, N–3, and N–4 to prescribe the methods of calculation to be used if performance data is included in the prospectus,[88] and to eliminate the requirements for information intended to satisfy the ''substance of which'' requirement. Form N–6, the newly adopted registration form for variable life insurance, will not contain any item concerning performance data because we have not prescribed any particular method for calculating variable life insurance performance.[89]

We also note that we are proposing to delete requirements in Forms N–1A, N–3, and N–4 that specifically require disclosure of the method of calculating performance, and the length of and the last day of the base period used in calculating a performance quotation, and requirements in Form N–1A that require disclosure of the income tax rate used in a performance calculation.[90] We emphasize, however, that if a fund chooses to include any performance information in its prospectus or SAI that is not required to be included by the applicable registration form, the fund is responsible for ensuring that the information is not incomplete, inaccurate, or misleading.[91] Thus, a fund should include any disclosure, including the method of calculating performance, and the dates of the performance and tax rates used, that is required to meet this responsibility.

We request comment on the proposed amendments to Forms N–1A, N–3, N–4, and N–6.

- If we eliminate the ''substance of which'' requirement from rule 482, are there other reasons why a fund should continue to be required to include information about its methods of calculating performance in its prospectus or SAI?
- For example, should a fund be required to include in the SAI a description of the methods by which

[81] Proposed paragraph (b)(5) of rule 482.

[82] Proposed paragraph (b)(5) of rule 482. The disclosure subject to the proximity requirement would include the disclosure required by proposed paragraph (b)(3) of rule 482 that the performance data quoted represents past performance; that past performance does not guarantee future results; in the case of a non-money market fund, that the investment return and principal value of an investment will fluctuate; that current performance may be lower or higher than the performance data quoted; and the toll-free telephone number and, if available, website where an investor may obtain month-end performance data.

[83] Rule 482(e)(1)(iv), (e)(2)(v), (e)(3)(iv), (e)(4)(vi), and (e)(5)(v) [17 CFR 230.482(e)(1)(iv), (e)(2)(v), (e)(3)(iv), (e)(4)(vi), and (e)(5)(v)].

[84] Proposed paragraphs (d)(1)(iv), (d)(2)(v), (d)(3)(iv), (d)(4)(vi), (d)(5)(v), and (e)(1)(i) of rule 482.

[85] Form N–1A [17 CFR 239.15A; 17 CFR 274.11A] is the registration form for open-end management investment companies. Form N–3 [17 CFR 239.17a; 17 CFR 274.11b] is the registration form for separate accounts organized as management investment companies that offer variable annuity contracts. Form N–4 [17 CFR 239.17b; 17 CFR 274.11c] is the registration form for separate accounts organized as unit investment trusts that offer variable annuity contracts. Form N–6 [17 CFR 239.17c; 17 CFR 274.11d] is the registration form for separate accounts that are registered as unit investment trusts and that offer variable life insurance policies.

[86] The statement of additional information contains more extensive and detailed information about a fund than is contained in the prospectus, and is required to be delivered to investors upon request.

[87] Investment Company Act Release No. 23064 (Mar. 13, 1998) [63 FR 13916, 13936–37 (Mar. 23, 1998)]; 1986 Advertising Proposing Release, *supra* note 24, at 34392.

[88] Under proposed rule 482, these methods would continue to apply to performance data included in advertisements, as well. *See, e.g.,* proposed paragraphs (d)(1)(i), (d)(2)(i), (d)(3)(i), (d)(4)(i), and (e)(1)(i) of rule 482.

[89] Investment Company Act Release No. 25522 (Apr. 12, 2002) [67 FR 19848, 19856 (Apr. 23, 2002)] (discussing variable life insurance performance).

[90] Item 21(a)(5) and (b)(7) of Form N–1A; Item 25(a)(iii), (a)(iv), (b)(i)(B), (b)(i)(C), (b)(ii)(B), (b)(ii)(C), (b)(iii)(B), and (b)(iii)(C) of Form N–3; Item 21(a)(iii), (a)(iv), (b)(i)(B), (b)(i)(C), (b)(ii)(B), (b)(ii)(C), (b)(iii)(B), and (b)(iii)(C) of Form N–4.

[91] *See* General Instruction C.3.(b) of Form N–1A; General Instruction 2 for Parts A and B of Form N–3; General Instruction 2 for Parts A and B of Form N–4; General Instruction C.3.(b) of Form N–6 (allowing information that is not otherwise required to be included in the prospectus or SAI so long as it is not incomplete, inaccurate, or misleading).

any non-standardized performance is calculated?

E. Compliance Date

If we adopt the proposed amendments, we intend that the amendment eliminating the ''substance of which'' requirement from rule 482 will take effect immediately upon the effective date of the amendments. We also expect to require fund advertisements used 90 days or more after the effective date of the amendments to comply with the amendments. The Commission requests comment on these proposed dates. Is 90 days an appropriate transition period for compliance, or should this be shorter or longer? Should we base compliance on the date an advertisement is used, or should we require compliance based on the date an advertisement is submitted for publication, or should we adopt some other alternative?

III. Request for Comments

A. Request for Comments on the Framework for Regulation of Investment Company Advertisements

The amendments we propose today would enhance the basic framework for fund performance advertising that we have had in place for many years. Since 1988, we have required mutual funds that advertise performance to include standardized performance numbers in their advertisements.[92] In that same period, the assets of the industry have grown from approximately $800 billion to over $7 trillion, and the number of available mutual funds has exploded from nearly 3,000 to over 8,000.[93] Also, the range of mutual funds available to investors has changed dramatically. Today, investors choose from a broad range of fund options with very different risk profiles, including, among others, money market funds, government bond funds, high-yield bond funds, domestic equity funds, and international equity funds.

Investors today face a daunting task when they attempt to sort through the wealth of available mutual fund options to choose an appropriate investment. In making those choices, investors frequently rely on investment performance.[94] Given the enormous growth and change in the fund industry in the past twenty-five years, the importance of fund sales materials to investor choices among funds, and the tendency of investors to emphasize performance in selecting mutual funds, we believe it is appropriate to reexamine the framework of regulation for investment company advertising and to consider whether it should be modified to better serve investors.

The Commission is undertaking an effort to modernize our rules and forms in many areas. In light of this effort, we are searching for ways to provide more meaningful and useful information to investors about mutual funds.

We request comment generally on whether the framework for the regulation of mutual fund advertising could be modified, and specifically on the following issues.

- Are there alternatives to the framework of regulation for investment company advertising that is presently in place that would more effectively protect investors?
- Has the role of advertisements changed over the past several years? Has the role of advertisements changed when compared to the role of the statutory prospectus? If so, how? Should we revise our approach to the regulation of fund advertisements in light of those changes?
- For example, would it be better simply to require that mutual fund advertisements adhere to general standards that would result in providing information that would assist the average investor without prescribing any regulation of the contents of advertisements, including standards for performance advertising?
- To what extent should standards for fund advertising be established by the Commission, and to what extent should they be established by other organizations, *e.g.,* NASDR? For example, should we require NASDR to play a larger role in establishing standards for advertising? Would the limits on NASDR jurisdiction (that it regulates only its members) pose any issues if NASDR were to assume a larger role in establishing the standards for fund advertising?
- Is the standardization of performance data necessary or helpful to enable investors to compare different funds or prevent fraudulent performance claims? Does the advertisement of standardized performance data obscure important factors, such as costs and risk, that vary from fund to fund and are important to an investment decision?
- Does the standardization of performance advertising encourage too much reliance on performance? Should our rules be designed to produce more qualitative information in advertisements? If so, how?
- Currently, our rules include standardized performance calculations for investment companies, but not for investment advisers. Does this difference make sense and, if not, what changes should we make?
- Should fund advertisements be required to include information about a variety of factors that are important in making an investment decision? If so, should the Commission prescribe the factors that should be covered (*e.g.,* investment objectives, fees, risk), or should the Commission simply establish a more general requirement that advertisements present a balanced discussion of qualitative and quantitative information that would assist the average investor?
- Is it helpful or necessary to prescribe the manner in which information should be presented in advertisements, *e.g.,* emphasis and location of information or font size?
- Should radio and television fund advertisements, or other forms of advertisement where the investor may not refer back to the advertisement, be regulated differently than print advertisements?
- What are the costs for funds, and indirectly for investors, as well as other parties, associated with various alternative means of regulating fund advertising?
- What liability standards should apply to fund advertisements?

B. General Request for Comments

The Commission requests comment on the amendments proposed in this release, suggestions for additional provisions or changes to existing rules or forms, and comments on other matters that might have an effect on the proposals contained in this release.

C. Request for Comments on Rule 482(a)(5)(i) Relating to Variable Insurance Contracts

We also wish to solicit comment on a provision of rule 482 relating to variable insurance contracts. Rule 482 generally prohibits a rule 482 advertisement from containing or being accompanied by an application to purchase fund shares.[95] In order to preserve the statutory prospectus as the primary disclosure document by encouraging investors to read the statutory prospectus before investing, a rule 482 advertisement is required to include a legend telling investors how to obtain a prospectus and directing

[92] 1988 Advertising Adopting Release, *supra* note 21.

[93] Investment Company Institute, *2001 Mutual Fund Fact Book* at 63 (41st ed.); Investment Company Institute, *Trends in Mutual Fund Industry: March 2002,* http://www.ici.org/facts_figures/trends_0302.html (Apr. 29, 2002).

[94] *See supra* note 37 and accompanying text.

[95] Rule 482(a)(5) [17 CFR 230.482(a)(5)].

them to read it before investing.[96] The prohibition against applications accompanying rule 482 advertisements was included in rule 482 because the Commission believed that permitting purchase applications in a rule 482 advertisement would undermine the purpose of the legend requirement.[97]

Rule 482 contains an exception from the prohibition against applications for unit investment trusts that offer variable annuity or variable life insurance contracts.[98] These contracts permit investors to allocate premiums among a variety of underlying mutual funds in which the unit investment trust invests. The contract prospectuses contain descriptions of the underlying mutual funds, which are considered rule 482 advertisements for the underlying funds.[99] The underlying funds are separately registered as management investment companies on Form N–1A and offer their shares through separate prospectuses. The exception from the prohibition on applications for variable insurance contracts permits an application for the contract (which provides for investor allocation of purchase payments to specific underlying funds) to accompany the contract prospectus, even though the contract prospectus constitutes a rule 482 advertisement for the underlying mutual funds and even though prospectuses for the underlying funds do not accompany the contract prospectus.[100]

In recent years, members of the variable insurance industry have requested that the Commission staff clarify the scope of the variable insurance exception from the application prohibition of rule 482. By its terms, the exception permits a contract application to accompany a rule 482 advertisement for the underlying funds only when the rule 482 advertisement is a part of the contract prospectus itself. Members of the industry have argued that it should be permissible for a contract prospectus and application to be accompanied by other rule 482 advertisements for the underlying funds that are not a part of the prospectus itself.

Advocates of this position argue that rule 482 permits either of the following: (i) Delivery of a rule 482 advertisement for an underlying fund (without an application); and (ii) delivery of a contract prospectus with an application. They therefore argue that, under rule 482, delivery of a rule 482 advertisement for an underlying fund (without an application) could be either preceded or followed by delivery of a contract prospectus with an application. As a result, they conclude that it should be permissible for a contract prospectus and application to be accompanied by other rule 482 advertisements for the underlying funds because whether the delivery of the additional rule 482 advertisements is made together with the contract material or separately from it is a question of form, rather than substance.

We believe that it would be useful to clarify the ambiguities in the scope of the insurance exception from the application prohibition of rule 482, so that issuers of variable insurance products may operate with greater certainty. Therefore, we request comment on this issue.

We request comment on rule 482(a)(5)(i) relating to variable insurance products.

- Should rule 482 advertisements for the underlying funds that are not contained in the contract prospectus itself be permitted to be delivered simultaneously with the contract prospectus and accompanying purchase application?
- Should we amend rule 482 to explicitly permit this practice, or should we amend rule 482 to explicitly prohibit this practice?
- Particularly in light of the fact that we are proposing to remove the ''substance of which'' requirement from rule 482, are there relevant differences between permitting a contract prospectus that is filed with the Commission and subject to strict liability under Section 11 of the Securities Act to be accompanied by an application and permitting additional rule 482 advertisements for the underlying funds that are not subject to Section 11 liability to be accompanied by an application?[101]
- Variable insurance products are one among many channels through which mutual funds are distributed. How would explicitly broadening, or confining, the scope of the insurance exception from the application prohibition affect other sectors of the fund industry that are not permitted to include fund applications with rule 482 advertisements? What would the competitive effects be within the variable insurance industry and as between the variable insurance industry and other sectors of the fund industry?
- Should the Commission reconsider the insurance exception for competitive or other reasons? Is the insurance exception consistent with investor protection, given the limited amount of information about the underlying funds that is typically contained in the contract prospectus? We note, for example, that the fee table of recently adopted Form N–6 for variable life insurance policies requires disclosure of the range of expenses of all underlying funds offered through a policy rather than the expenses of each fund and that the Commission has proposed conforming amendments to the fee table of Form N–4 for variable annuities.[102]

IV. Cost/Benefit Analysis

The Commission is sensitive to the costs and benefits associated with its rules. The Commission requests comment and empirical data regarding the costs and benefits of the proposed amendments to the advertising rules.

A. Introduction

The Commission is proposing rule amendments under the Securities Act and the Investment Company Act. To provide funds with the ability to disclose more timely information in advertisements, the proposed amendments would remove the ''substance of which'' requirement contained in rule 482 under the Securities Act, and would rescind the provisions in rule 134 under the Securities Act that apply to funds. In addition, the proposed amendments would reinforce the antifraud protections in the fund advertising rules, and would require enhanced disclosure of certain information in fund advertisements designed to encourage advertisements that convey balanced information to prospective investors. Finally, the proposed amendments would make certain organizational changes to rule 482 and

[96] Rule 482(a)(3)(i) [17 CFR 230.482(a)(3)(i)]; proposed paragraph (b)(1)(i) of rule 482.

[97] 1986 Advertising Proposing Release, *supra* note 24, at 34391 nn. 57–60 and accompanying text.

[98] Rule 482(a)(5)(i) [17 CFR 230.482(a)(5)(i)]; proposed paragraph (c)(1) of rule 482. A rule 482 advertisement may also be accompanied by an application when the advertisement is used with a profile permitted by rule 498 under the Securities Act. Rule 482(a)(5)(ii) [17 CFR 230.482(a)(5)(ii)]. *See* proposed paragraph (c)(2) of rule 482.

[99] *See* Item 5(c) of Form N–4 and Item 4(c) of Form N–6 (requiring brief description of each underlying mutual fund offered through the contract). *See also* Investment Company Act Release No. 14575 (June 14, 1985) [50 FR 26415, 26155 n. 48 and accompanying text (June 25, 1985)] (describing treatment of description of underlying mutual funds in contract prospectus as omitting prospectuses).

[100] *See* 1986 Advertising Proposing Release, *supra* note 87, at 34391 n. 60.

[101] Section 11 imposes strict liability on issuers, as well as other persons, including directors and underwriters, for material misstatements and omissions contained in the registration statement. 15 U.S.C. 77k.

[102] Investment Company Act Release No. 25522, *supra* note 89 (adopting Form N–6); Investment Company Act Release No. 25521 (Apr. 12, 2002) [66 FR 19885 (Apr. 23, 2002)] (proposing changes to fee table of Form N–4).

technical amendments to the registration forms.

1. Present Fund Advertising Rules

Like most issuers of securities, when an investment company (''fund'') offers its shares to the public, its promotional efforts become subject to the advertising restrictions of the Securities Act. Congress imposed these restrictions so that investors would base their investment decisions on the full disclosures contained in the ''statutory prospectus,'' which Congress intended to be the primary selling document.[103] The advertising restrictions of the Securities Act cause special problems for many investment companies, particularly for open-end management investment companies (''mutual funds'') and other investment companies that continuously offer and sell their shares. For these funds, the advertising restrictions apply continuously because the offering process, in effect, is continuous. To address these problems, the Commission has adopted a number of special advertising rules for investment companies, including rule 482 and rule 134.

Rule 482

The Commission adopted rule 482 under the authority of section 10(b) of the Securities Act, which permits the Commission to adopt rules that provide for a prospectus that omits ''in part'' or ''summarizes'' information in the statutory prospectus.[104] Rule 482 permits investment companies to advertise any information ''the substance of which'' is included in the statutory prospectus.[105] The theory behind the ''substance of which'' requirement is that an advertisement cannot be one that ''omits'' information from the statutory prospectus unless all of the information in the advertisement is derived from information in the statutory prospectus.[106] Significantly, rule 482 provides a means for mutual funds to advertise performance information according to standardized formulas.[107] Rule 482 also requires advertisements to comply with certain disclosure requirements, particularly when presenting performance figures.[108]

Rule 134

In contrast to rule 482, rule 134 is a content-based rule that specifies certain categories of information that a fund may advertise. Originally, rule 134 communications, known as ''tombstone advertisements,'' were intended merely to announce the existence of a public offering and serve as a simple means for soliciting inquiries for the statutory prospectus.[109] Over the years, however, the Commission has amended rule 134, broadening the permissible categories of information that a fund may include in its tombstone advertisements.[110] Today, funds may advertise a broad range of information under rule 134, other than performance information.[111]

2. Present Burden of Fund Advertising Rules

Based on the Commission staff's discussions with certain fund complexes and its experience with the various types of investment companies registered with the Commission, we estimate that the current annual hour burden associated with rule 482 and rule 134 is approximately 40.275 hours per investment company.[112] For the industry overall, this represents 225,015 (40.275 hours per investment company × 5,587 investment companies) burden hours, or $9,222,465 (225,015 hours × $40.986 wage rate) in internal costs.[113] Another 89,143 hours, or $3,653,615 (89,143 hours × $40.986 wage rate) in internal costs, are imposed by the requirement that funds comply with rule 34b–1 under the Investment Company Act, which requires that any performance data included in supplemental sales literature be accompanied by performance data computed using the standardized formulas for advertising performance under rule 482.[114] The Commission estimates that external costs presently associated solely with the regulatory burden of complying with the advertising rules are negligible.[115] The benefits and costs associated with the proposed amendments affect these totals as indicated in the discussion that follows.

B. Benefits

The proposed amendments would modify rule 482 of the Securities Act and related rules and forms, to provide more timely, informative, and balanced information in fund advertising for the benefit of investors. The amendments would also simplify and clarify the advertising rules, thus reducing regulatory compliance costs, and these cost savings may be passed on to investors.

1. Enhanced Disclosure of Information to Investors

Currently, the regulations concerning advertising include significant disclosure requirements. The proposed amendments would enhance the disclosure provided to investors in fund advertising in several respects:

• *Availability of Monthly Performance Figures.* Advertisements would have to disclose the availability of updated monthly performance figures by a toll-free telephone number, and, if

---

[103] ''Statutory prospectus'' refers to the full prospectus required by Section 10(a) of the Securities Act. 15 U.S.C. 77j(a).

[104] 15 U.S.C. 77j(b). *See also* 1979 Advertising Adopting Release, *supra* note 18.

[105] Rule 482(a)(2) under the Securities Act [17 CFR 230.482(a)(2)].

[106] 1977 Advertising Proposing Release, *supra* note 20, at 30380.

[107] *See supra* note 21.

[108] Because a rule 482 advertisement is a prospectus under section 10(b) of the Securities Act [15 U.S.C. 77j(b)], a rule 482 advertisement is subject to section 12(a)(2) of the Securities Act [15 U.S.C. 77*l*(a)(2)], which imposes liability for materially false or misleading statements in a prospectus or oral communication, subject to a reasonable care defense. Rule 482 advertisements are also subject to the antifraud provisions of the federal securities laws.

[109] *See supra* note 26.

[110] *See supra* note 27.

[111] Because the Commission adopted rule 134 under section 2(a)(10)(b) of the Securities Act, rule 134 advertisements are not considered prospectuses. As a result, rule 134 advertisements do not create liability under section 12(a)(2) of the Securities Act, which by its terms applies only to prospectuses and oral communications. Rule 134 advertisements, however, are subject to liability under the antifraud provisions of the federal securities laws.

[112] This figure was determined based on averages derived from information from nine fund complexes that offer mutual funds or variable insurance products. Because there was little data for closed-end funds, the burden hours for closed-end funds were based on estimates from one fund complex that offers closed-end funds and the Commission staff that these funds would incur approximately 8% of the burden of open-end funds.

[113] These figures are based on a Commission estimate of 5587 investment companies and an estimated hourly wage rate of $40.986. The estimate of the number of investment companies is based on data derived from the Commission's EDGAR filing system. The estimated wage rate figure is based on published hourly wage rates for in-house attorneys ($38.95), paralegals ($20.94), and compliance inspectors ($22.60) and the estimate, based on the Commission staff's discussions with certain fund complexes, that attorneys would account for 50% of hours spent on advertising regulation and that paralegal and compliance inspectors would account for the remaining 50% in equal ratio, yielding a weighted wage rate of $30.36 (($38.95 × .50) + ($20.94 × .25) + (22.60 × .25) = $30.36). Securities Industry Association, *Report on Office Salaries in the Securities Industry 2000* (Oct. 2000); Securities Industry Association, *Report on Management & Professional Earnings in the Securities Industry 2000* (Oct. 2000). This weighted wage rate was then adjusted upward by 35% for overhead, reflecting the costs of supervision, space, and administrative support, to obtain the total per hour internal cost of $40.986 ($30.36 × 1.35 = $40.986).

[114] 17 CFR 270.34b–1. These estimates are based on the number of pieces of sales literature filed annually with the Commission and the NASD, and the estimated wage rate described above in note 113.

In addition, Rule 156 under the Securities Act [17 CFR 230.156] is an interpretive regulation giving guidance as to whether sales literature is materially misleading. There is no cost associated directly with this rule.

[115] External costs might include, for example, costs of hiring outside counsel or accountants, or purchasing new equipment.

available, a website where an investor may obtain performance data current to the most recent month-end.[116] Easy access to and awareness of this information would benefit investors not only by providing potentially more accurate and timely performance data and reducing the ability of funds to selectively use performance data, but also by highlighting for investors the limitations of relying too heavily on any one set of performance figures.

• *Warning Legend.* If an advertisement provides performance figures, the proposed amendments would require the inclusion of an amended legend stating that past performance does not guarantee future results, and that current performance may be lower or higher than the data quoted.[117] This legend would benefit investors by making them more aware of the limitations of relying on performance data for investment decisions, and thus may result in more informed investment decisions.

• *Availability of Charge and Expense Information.* Advertisements would have to highlight the availability of information concerning charges and expenses in the statutory prospectus.[118] This provision would benefit investors by providing easy access to an important factor that would affect their returns, which in turn would allow investors to more easily compare the costs of competing funds.

• *Prominence Requirements.* Advertisements would be required to present certain disclosures, including those discussed above, (i) in a size and type style at least as prominent as that used in the major portion of the advertisement, or (ii) in the case of radio or television advertisements, with emphasis equal to that used in the major portion of the advertisement.[119] This provision would ensure that advertisers do not marginalize or minimize the presentation of the required disclosure described above. The provision also helps to ensure some uniformity between different advertisements, facilitating investors' ability to compare the products of competing funds.

• *Proximity Requirement.* In addition, the required disclosures regarding performance data would have to be identified in the body of the advertisement in close proximity to the performance data and not in a footnote, or, with regard to television or radio advertisements, presented in close proximity to the performance data.[120] The length of and the date of the last day in the base period used in computing yield quotations, average annual total returns, after-tax returns, and other performance measures would have to be adjacent to the performance data.[121] As with other disclosure requirements, this provision would help investors to more easily find information necessary to evaluate the performance figures shown and would help to remind investors of the limitations of performance data.

The benefits of these enhanced disclosure requirements to investors may be limited by the extent to which funds currently provide this disclosure voluntarily. Staff discussions with members of the fund industry indicate that most investment companies already comply with many of the requirements of the proposed amendments, by, for example, calculating performance data on at least a monthly basis, inserting warnings in advertisements that past performance is no guarantee of future performance, and operating websites and telephone call banks.

Nevertheless, the enhanced disclosure requirements would provide two benefits to investors. To the extent investment decisions are made based on advertising, the improved disclosure would result in investors making better informed investment decisions, and therefore in a more efficient distribution of assets by investors among different funds. The transparency resulting from the enhanced disclosure in fund advertising may, in turn, also contribute to increased competition among funds and result in a more efficient allocation of resources among competing investment products. Although it is not possible to quantify the beneficial effects of more efficient allocation of investors' assets and increased competition, they may be significant, given the size of the mutual fund industry.[122] We request comment on the nature and magnitude of the benefits to investors resulting from enhanced disclosure of information that would be required by the proposed amendments.

2. Simplification and Clarification of Fund Advertising Rules

The proposed amendments would add clarifying language to rule 482 and rule 156 under the Securities Act and rule 34b–1 under the Investment Company Act to reemphasize the separate applicability of the antifraud provisions of the federal securities laws. In addition, the proposed amendments would reorganize and modify rule 482 to make it easier for funds to apply, by adding headings, reordering provisions, and clarifying certain language.

The proposed amendments to rule 482 may aid funds and others in understanding and complying with the advertising rules, making it easier and cheaper for funds to advertise. This may, in turn, contribute to an increased flow of useful investment information to investors, which may lead to better-informed investment decisions and amplify the previously discussed benefits of efficient asset allocation.[123] Although difficult to quantify, this easing of regulation may provide some reduction of burden to the funds that choose to advertise. We request comment on the nature and magnitude of the benefits resulting from this reduction of regulatory burden.

3. Elimination of the ''Substance of Which'' Requirement and the Rescission of Rule 134 Provisions That Apply to Funds

To simplify the current structure of fund advertising rules and to provide funds the ability to disclose more timely information in advertisements, the proposed amendments would also remove the ''substance of which'' limitation contained in rule 482, allowing funds to include in their 482 advertisements material that is not included in the statutory prospectus. These amendments would render the current distinction between rule 482 and rule 134 advertisements unnecessary. As such, the proposed amendments would also rescind the provisions of rule 134 that apply to funds.

The elimination of the ''substance of which'' requirement would enable funds to avoid the need to include or update advertising related information in their prospectus or SAI, both in the initial registration statements and in post-effective amendments, before issuing an advertisement to the public. This would reduce filing costs for funds, including both internal costs and external costs such as outside legal fees.

[116] Proposed paragraph (g)(2) of rule 482.

[117] Proposed paragraph (b)(3)(i) of rule 482.

[118] Proposed paragraph (b)(1)(i) of rule 482. This disclosure would also be required in an advertisement used with a profile pursuant to rule 498 under the Securities Act. Proposed paragraph (b)(1)(ii) of rule 482.

[119] Proposed paragraph (b)(5) of rule 482.

[120] *Id.*

[121] Proposed paragraphs (d)(1)(iv), (d)(2)(v), (d)(3)(iv), (d)(4)(vi), and (d)(5)(v) of rule 482.

[122] *See* Investment Company Institute, *Trends in Mutual Fund Investing: March 2002, supra* note 93 (assets of mutual funds total $7.1 trillion).

[123] The trade-off between lower advertising burdens and increased advertising activity is complex and further complicated by business cycles and marketing strategy among other factors. We believe, however, that investors and funds would enjoy benefits in any event—either resources would be saved in reducing the costs and burdens of advertising or they would be spent to increase the amount and timeliness of information provided to investors in advertising.

The proposed amendments would also reduce the cost to the funds of printing and distributing prospectuses and SAIs. The elimination of unnecessary material from the prospectus or SAI may also help investors and others more easily understand the remaining information.

Finally, the proposed rescission of the rule 134 provisions that apply to funds would consolidate the regulation of most fund advertising in one rule as rule 482, as amended, would then cover advertisements now covered by rule 134. This simplification would contribute to the benefits of easier and cheaper advertising as discussed in section IV.B.2 (''Simplification and Clarification of Advertising Rules'') above, principally by removing the unnecessary restrictions on the content of the advertisements and the unnecessary distinction with regard to their legal classification. The transfer of fund advertising regulation from rule 134 to rule 482 may also enhance investor protection by subjecting all fund advertisements to potential civil liability under section 12(a)(2) of the Securities Act.[124] The Commission requests comment on the increase in potential liability under section 12(a)(2) for issuers that currently rely on rule 134 for their advertising.

The Commission estimates that, on an annual basis, these benefits will save funds approximately 1.96 burden hours, or $80.33, per investment company in internal costs but only negligible amounts in external costs. We estimate that 5587 investment companies will be affected by the proposed amendments, and, thus, the Commission estimates that the annual internal burden associated with rule 482, for purposes of the Paperwork Reduction Act, will decrease by approximately 10,950 (1.96 hours per investment company × 5,587 investment companies) burden hours.[125] These burden hours represent a monetary savings of approximately $448,797 (10,950 hours × $40.986 wage rate) per year.[126] We request comment on this estimate and on the nature and magnitude of any other benefits that would result from the proposed amendments.

C. Costs

The Commission estimates that the costs of the proposed amendments, in the aggregate, would be minimal and limited in duration. The Commission estimates that funds would incur one-time costs in modifying their current rule 482 advertising to meet the new disclosure and presentation requirements, although many funds already provide the disclosure that would be required and make available more current performance information voluntarily. For example, funds may have to modify their layouts and typesetting in order to convert existing advertisements to meet the requirements of the rule, or alternatively, replace existing advertisements more quickly than they otherwise would. However, the proposed amendments would allow a 90-day transition period, enabling funds to come into compliance with the new requirements in their next generation of quarterly advertisements with smaller conversion or replacement costs.

In addition, the requirement for funds to provide access to performance figures that are current as of the last month end may also impose costs, some of which would be ongoing, both to generate such figures on a monthly basis and to provide the information by a toll-free telephone number. This could include costs for computer time, accounting personnel, information technology staff, and additional computer and telephone equipment. However, many, if not most, funds already provide this or more current performance information through these means and, therefore, the marginal cost for most funds for making updated performance information available is expected to be negligible.

The elimination of the ''substance of which'' requirement and the rescission of rule 134 as applicable to funds may require some funds to incur costs to convert many of their tombstone advertisements to rule 482 advertisements. These costs, however, should be minimal and non-recurring, since the rule 482 requirements would permit advertisements that are not significantly different from those currently permitted under current rule 134.

The Commission estimates the one-time switchover costs for each investment company attributable to the proposed amendments would be approximately 2.18 hours, or $89.35 (2.18 hours × $40.986 wage rate), in internal costs, and $2,417 in external costs.[127] In total this represents a one-time cost of approximately 12,180 internal burden hours (translating into approximately $499,209 (12,180 hours × $40.986 wage rate) in internal costs) and $13,503,779 ($2,417 cost per investment company × 5,587 investment companies) in external costs.[128] We request comment on this estimate, and on the nature and magnitude of any other costs to funds resulting from the proposed amendments.

D. Conclusion

The Commission expects that the proposed advertising rule amendments will encourage more informed and efficient investing, while easing the regulatory burden on fund advertising, and that these likely benefits would justify the associated costs. To assist in the evaluation of the costs and benefits that may result from the proposed amendments, the Commission requests that commenters provide views and data relating to any anticipated costs and benefits associated with these proposals.

V. Consideration of Effects on Efficiency, Competition, and Capital Formation

Section 2(c) of the Investment Company Act, section 2(b) of the Securities Act, and Section 3(f) of the Securities Exchange Act of 1934 (''Exchange Act'') require the Commission, when engaging in rulemaking that requires it to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.[129]

The proposed amendments seek to improve fund advertising by enhancing disclosure requirements and by simplifying and clarifying the rules, including elimination of the ''substance of which'' requirement. These changes may improve efficiency. The rule simplifications may lower the regulatory burden on funds engaged in advertising, freeing resources for more productive uses. For example, funds would no longer have to update their prospectuses or SAIs in order to change the types of performance information in

[124] The benefits of potential direct investor suits in both remedying fraudulent advertising by funds and deterring such advertising in the future are difficult to quantify, but may be significant. The benefits would be reduced to the extent that the potential liability would increase litigation and insurance costs for funds. However, because suits based on misleading advertising are relatively rare, we estimate that this cost would be minimal.

[125] The estimate of the number of investment companies is based on data derived from the Commission's EDGAR filing system. The estimate of the decrease in burden hours is based on information gathered from the fund industry by the Commission staff and from the staff's experience with the various advertising regulations.

[126] See discussion in note 113, *supra*, regarding wage rate.

[127] These figures are based on averages derived from information gathered from several members of the fund industry by the Commission staff and from the staff's experience with the various advertising rules. Internal costs would include, for example, the cost of reviewing all fund advertisements for compliance with the revised rules. External costs would include, for example, the costs of typesetting and printing for new fund advertisements.

[128] See discussion in note 113, *supra*, regarding wage rate.

[129] 15 U.S.C. 77b(b), 78c(f), and 80a–2(c).

advertisements. The enhanced disclosure requirements may provide greater and timelier access by investors to updated performance figures, which would promote more efficient allocation of investments by investors and more efficient allocation of assets among competing funds. The proposed amendments may also improve competition, as enhanced disclosure may prompt funds to seek to provide better-informed investors with improved products and services. Finally, the effects of the proposed amendments on capital formation are unclear. Although, as noted above, we believe that the proposed amendments would benefit investors, the magnitude of the effect of the proposed amendments on efficiency, competition, and capital formation is difficult to quantify, particularly given that most funds may already comply with at least some of the new disclosure requirements.

We request comment on whether the proposed amendments, if adopted, would promote efficiency, competition, and capital formation. Commenters are requested to provide empirical data and other factual support for their views if possible.

VI. Paperwork Reduction Act

A. Introduction

Certain provisions of the proposed amendments contain ''collection of information'' requirements within the meaning of the Paperwork Reduction Act of 1995 [44 U.S.C. 3501, *et seq.*], and the Commission is submitting the proposed collections of information to the Office of Management and Budget (''OMB'') for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The titles for the existing collections of information are: (i) ''Form N–1A under the Investment Company Act of 1940 and Securities Act of 1933, Registration Statement of Open-End Management Investment Companies''; (ii) ''Form N–2—Registration Statement of Separate Accounts Organized as Management Investment Companies'' [130] (iii) ''Form N–3—Registration Statement of Separate Accounts Organized as Management Investment Companies''; (iv) ''Form N–4—Registration Statement of Separate Accounts Organized as Unit Investment Trusts''; (v) ''Form N–6 Under the Investment Company Act and the Securities Act of 1933, Registration Statement of Insurance Company Separate Accounts Registered as Unit Investment Trusts that Offer Variable Life Insurance Policies''; and (vi) ''Rule 34b–1 of the Investment Company Act of 1940, Sales Literature Deemed to Be Misleading.'' A new collection of information is being created entitled ''Rule 482 under the Securities Act of 1933, Advertising by an Investment Company.''[131] An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number.

Form N–1A (OMB Control No. 3235–0307), Form N–2 (OMB Control No. 3235–0026), Form N–3 (OMB Control No. 3235–0316), Form N–4 (OMB Control No. 3235–0318), and Form N–6 (OMB Control No. 3235–0503) were adopted pursuant to section 5 of the Securities Act [15 U.S.C. 77e] and section 8(a) of the Investment Company Act [15 U.S.C. 80a–8(a)]. Rule 482 of Regulation C was adopted pursuant to section 10(b) of the Securities Act [15 U.S.C. 77j(b)]. Rule 34b–1 (OMB Control No. 3235–0346) was adopted pursuant to section 34(b) of the Investment Company Act [15 U.S.C. 80a–33(b)].

The proposed amendments would modify rule 482 of the Securities Act and related rules and forms, to provide more timely, understandable, and balanced information in fund advertising for the benefit of investors, while simplifying and clarifying the advertising rules for the benefit of funds.[132] First, the proposed amendments would enhance the disclosure that funds would be required to provide in advertisements, including by highlighting the availability of information concerning charges and expenses and requiring an amended legend warning that past performance does not guarantee future results. The proposed amendments would also set forth requirements ensuring that funds present these and other required disclosures at least as prominently as the material included in the body of the advertisement. Second, if a fund advertisement includes performance data, the fund would have to make available to investors month-end performance figures by a toll-free telephone number, and disclosed the availability of month-end performance data in the advertisement. Third, the proposed amendments would add clarifying language to rule 482 under the Securities Act and rule 34b–1 under the Investment Company Act to reemphasize the separate applicability of the antifraud provisions of the federal securities laws, and would amend rule 156 under the Securities Act to provide further guidance regarding the factors to be weighed in determining whether a statement involving a material fact in investment company sales literature is or might be misleading. Fourth, to allow funds the ability to disclose more timely information in advertisements, the proposed amendments would remove the ''substance of which'' limitation contained in rule 482 and would rescind the provisions in rule 134 under the Securities Act that apply to funds. Fifth, the proposed amendments would clarify portions of rule 482 (without changing their content) by adding headings, reordering provisions, and simplifying certain provisions. Finally, the amendments would make technical and conforming changes to Forms N–1A, N–3, N–4, and N–6 to reflect all the rule changes listed above.

The analysis in this PRA summary is divided in two sections. Section VI.B. (''The Registration Forms Burden'') discusses the current PRA burden attributable to the fund advertising rules, which is presently allocated to the collections of information for the various registration forms, and the transfer of this burden to a new collection of information category for rule 482. Section VI.C. (''Change in Burden Attributable to Proposed Amendments'') discusses the net change in burden hours attributable to the proposed amendments for both the new collection of information for rule 482 and the existing collection of information for rule 34b–1.

B. The Registration Forms Burden

Presently, the PRA burdens imposed by rule 482 are accounted for under the various registration forms used by

[130] Although the proposed amendments would not amend Form N–2, that form is included in this Paperwork Reduction Act summary because the PRA burden for rule 482 has previously been included in the various investment company registration statement forms affected by rule 482, including Form N–2. As discussed below, the Commission is transferring the PRA burden associated with rule 482 from all of these registration statement forms to a new rule 482 category.

[131] The proposed amendments would modify rule 482, which is part of Regulation C under the Securities Act of 1933. Regulation C describes the disclosure that must appear in registration statements under the Securities Act and Investment Company Act. The Paperwork Reduction Act (''PRA'') burden associated with rule 482 has previously been included in the various investment company registration statement forms, not in Regulation C. However, because the proposed amendments would eliminate the rationale for allocating the PRA burden for rule 482 to the registration forms, the Commission proposes to transfer the burden associated with rule 482 to a new category. While this transfer and the fluctuation in the numbers of filings would affect the burden hours for the various forms, the proposed amendments to the forms would not have any effect on the burden hours for the forms.

[132] The Commission is proposing amendments to rules 134, 156, and 482 under the Securities Act, rule 34b–1 under the Investment Company Act, and Forms N–1A, N–3, N–4, and N–6 under the Investment Company Act and Securities Act.

investment companies affected by the rule: Form N–1A, Form N–2, Form N–3, Form N–4, and Form N–6. We intend to remove these burden hours associated with rule 482 and place them in a separate rule 482 category in the following amounts:

Form	Hours transferred
Form N–1A	177,514
Form N–2	1,014
Form N–3	792
Form N–4	36,630
Form N–6	9,065
Total hours to be transferred to new rule 482 category	225,015

The information required to be filed with the Commission pursuant to the information collections contained in the registration forms permits the verification of compliance with securities law requirements and assures the public availability and dissemination of the information.

1. Form N–1A

The purpose of Form N–1A is to meet the registration and disclosure requirements of the Securities Act and the Investment Company Act and to enable funds to provide investors with information necessary to evaluate an investment in the fund. The respondents to this information collection are open-end funds registering with the Commission. Compliance with the disclosure requirements on Form N–1A is mandatory. Responses to the disclosure requirements are not confidential.

The current hour burden for preparing an initial Form N–1A filing is 824 burden hours per portfolio, and the Commission attributes 23 of these burden hours per portfolio to compliance with rule 482, reducing the remaining burden hours per portfolio to 801.[133] The current annual hour burden for preparing post-effective amendments on Form N–1A is 122 hours per portfolio, and the Commission attributes 23 of these burden hours per portfolio to rule 482, reducing the remaining burden hours per portfolio to 99. The Commission estimates that, on an annual basis, 193 portfolios file initial registration statements on Form N–1A and 7,525 file post-effective amendments on Form N–1A. Thus, the burden hours attributable to rule 482 to be transferred from Form N–1A to the new rule 482 collection of information equal 177,514 ((23 hours × 193 portfolios) + (23 hours × 7,525 portfolios)). After shifting the rule 482 burden hours to a new collection of information, the total burden hours that remain allocated to Form N–1A for all purposes unassociated with rule 482 would be 899,568 ((801 hours × 193 portfolios) + (99 hours × 7,525 portfolios)).

Except for the transfer of PRA burden from the Form N–1A to the new collection of information for rule 482, the Commission estimates no effect on the remaining PRA burden for Form N–1A from the proposed amendments. The change in PRA burden resulting from the purposed amendments is accounted for under the new rule 482 collection of information.

2. Form N–2

The purpose of Form N–2 is to meet the registration and disclose requirements of the Securities Act and the Investment Company Act and to enable funds to provide investors with information necessary to evaluate an investment in the fund. The respondents to this information collection are closed-end funds registering with the Commission. Compliance with the disclosure requirements of Form N–2 is mandatory. Responses to the disclosure requirements are not confidential.

The current hour burden for preparing an initial registration statement on Form N–2 is 542.4 burden hours per filing, and the current hour burden for preparing a post-effective amendment on Form N–2 is 107.4 hours per filing. The Commission attributes 5.7 of these burden hours per filing to compliance with rule 482, reducing the burden hours per filing to 536.7 and 101.7, respectively. The Commission currently estimates that, on an annual basis, 140 respondents file an initial registration statement on Form N–2 and 38 file post-effective amendments on Form N–2. Thus, the burden hours attributable to rule 482 to be transferred from N–2 to the new rule 482 collection of information equal 1,014 ((5.7 hours × 140 filings) + (5.7 hours × 38 filings)). After shifting the rule 482 burden hours to a new collection of information, the total burden hours that remain allocated to Form N–2 for all purposes unassociated with rule 482 would be 79,003 ((536.7 hours × 140 filings) + (101.7 hours × 38 filings)).

Except for the transfer of PRA burden from Form N–2 to the new collection of information for rule 482, the Commission estimates no effect on the remaining Form N–2 PRA burden from the proposed amendments. The change in PRA burden resulting from the proposed amendments is accounted for under the new rule 482 collection of information.

3. Form N–3

The purpose of Form N–3 is to meet the registration and disclosure requirements of the Securities Act and the Investment Company Act and to enable funds to provide investors with information necessary to evaluate an investment in the fund. The respondents to this information collection are separate accounts, organized as management investment companies and offering variable annuities, registering with the Commission. Compliance with the disclosure requirements of Form N–3 is mandatory. Responses to the disclosure requirements are not confidential.

The current annual hour burden for preparing an initial registration statement on Form N–3 is 910.5 hours per portfolio, and the Commission attributes 3.3 of these burden hours per portfolio to compliance with rule 482, reducing the remaining burden hours per portfolio to 907.2.[134] The current annual hour burden for preparing post-effective amendments on Form N–3 is 151.7 hours per portfolio, and the Commission attributes 3.3 of these burden hours per portfolio to rule 482, reducing the remaining burden hours per portfolio to 148.4. The Commission estimates that, on an annual basis, no initial registration statements will be filed on Form N–3 and 60 post-effective amendments, including 240 portfolios, will be filed on Form N–3. Thus, the burden hours attributable to rule 482 to be transferred from Form N–3 to the new rule 482 collection of information equal 792 (3.3 hours × 240 portfolios). After shifting the rule 482 burden hours to a new collection of information, the total burden hours that remain allocated to Form N–3 for all purposes unassociated with rule 482 would be 35,616 (148.4 × 240 portfolios).

Except for the transfer of PRA burden from Form N–3 to the new collection of

[133] The estimate of the burden hours attributable to compliance with rule 482 for filings on Forms N–1A and Form N–2 are based on information supplied to the Commission staff by members of the fund industry and the staff's experience with these registration forms.

[134] Estimates of the burden hours attributable to rule 482 for Forms N–3, N–4, and N–6 were derived by estimating the total burden hours for compliance with rule 482 for all variable insurance separate accounts, based on the staff's discussions with a member of the variable insurance products industry that issues both variable annuities and variable life insurance policies. This estimate of the total rule 482 burden hours for variable insurance products filings was allocated among Form N–3, Form N–4 and Form N–6 filings based on the ratio of burden hours previously allocated to each of these forms for PRA purposes. However, we excluded burden hours attributable to initial filings on Form N–3 because we currently anticipate no such filings.

information for rule 482, the Commission estimates no effect on the remaining PRA burden for Form N–3 resulting from the proposed amendments. The change in PRA burden resulting from the proposed amendments is accounted for under the new rule 482 PRA collection of information.

4. Form N–4

The purpose of Form N–4 is to meet the registration and disclosure requirements of the Securities Act and the Investment Company Act and to enable separate accounts issuing variable annuity contracts to provide investors with information necessary to evaluate an investment in a contract. The respondents to this information collection are separate accounts, organized as unit investment trusts and offering variable annuities, registering with the Commission. Compliance with the disclosure requirements of Form N–4 is mandatory. Responses to the disclosure requirements are not confidential.

The current hour burden for preparing an initial Form N–4 filing is 298 burden hours per filing, and the Commission attributes 24.8 of these burden hours per filing to rule 482, reducing the remaining burden hours per filing to 273.2.[135] The current annual hour burden for preparing post-effective amendments on Form N–4 is 219.8 hours per filing, and the Commission attributes 24.8 of these burden hours per filing to rule 482, reducing the remaining burden hours per filing to 195. The Commission estimates that, on an annual basis, 157 respondents file initial registration statements on Form N–4 and 1320 respondents file post-effective amendments on Form N–4. Thus, the burden hours attributable to rule 482 to be transferred from Form N–4 to the new rule 482 collection of information equal 36,630 ((24.8 hours × 157 filings) + (24.8 hours × 1320 filings)). After shifting the rule 482 burden hours to a new collection of information, the total hour burden that remains allocated to Form N–4 for all purposes unassociated with rule 482 would be 300,292 ((273.2 hours × 157 filings) + (195 hours × 1320 filings)).

Except for the transfer of PRA burden from Form N–4 to the new collection of information for rule 482, the Commission estimates no effect on the remaining PRA burden for Form N–4 resulting from the proposed amendments. The change in PRA burden resulting from the proposed amendments is accounted for under the new rule 482 PRA collection of information.

5. Form N–6

The purpose of Form N–6 is to meet the registration and disclosure requirements of the Securities Act and the Investment Company Act and to enable separate accounts issuing variable life insurance policies to provide investors with information necessary to evaluate an investment in a policy. The respondents to this information collection are separate accounts, organized as unit investment trusts and offering variable life insurance policies, registering with the Commission. Compliance with the disclosure requirements of Form N–6 is mandatory. Responses to the disclosure requirements are not confidential.

The current hour burden for preparing an initial registration statement on Form N–6 is 800 burden hours per filing and the hour burden for a post-effective amendment on Form N–6 is 100 hours per post-effective amendment filed as an annual update, and 10 hours per post-effective amendment filed for other purposes. The Commission attributes 35 of these burden hours per filing to compliance with rule 482 for both initial registration statements and post-effective amendments that are annual updates.[136] The Commission estimates no burden hours associated with rule 482 for additional post-effective amendments that are not annual updates. The Commission estimates that, on an annual basis, 59 initial registration statements will be filed on Form N–6 and 500 post-effective amendments will be filed on Form N–6, 200 as annual updates and 300 as additional post-effective amendments.[137] Thus, the burden hours attributable to rule 482 to be transferred from Form N–6 to the new rule 482 collection of information equal 9,065 ((35 hours × 59 filings) + (35 hours × 200 filings)). The total hour burden that remains allocated to Form N–6 for all purposes unassociated with rule 482 would be 61,135 ((765 hours × 59 filings) + (65 hours × 200 filings) + (10 hours × 300 filings)).

Except for the transfer of PRA burden from Form N–6 to the new collection of information for rule 482, the Commission estimates no effect on the remaining PRA burden for Form N–6 resulting from the proposed amendments. The change in PRA burden resulting from the proposed amendments is accounted for under the new rule 482 PRA collection of information.

C. Change in Burden Attributable to Proposed Amendments

The information required by the proposed amendments to the advertising rules is primarily for the use and benefit of investors. The Commission is concerned that investors receive information in advertisements that is accurate, balanced, timely, not misleading, and otherwise appropriate and helpful in making investment decisions. The additional information that would be required to be disclosed to investors pursuant to the collection of information provisions of the rules affected by the proposed amendments, would address these concerns regarding investor protection.

1. Rule 34b–1

Rule 34b–1, including the proposed amendments, contains collection of information requirements. The rule applies to supplemental sales literature, *i.e.,* sales literature that is preceded or accompanied by the statutory prospectus and requires the inclusion of standardized performance data in sales literature that includes performance data. Compliance with rule 34b–1 is mandatory for every registered investment company that issues supplemental sales literature. Responses to the disclosure requirements will not be kept confidential.

We estimate that approximately 37,000 responses are filed annually pursuant to rule 34b–1, and the burden per response is 2.9 hours. The proposed amendments would change rule 34b–1 only to add language to clarify the Commission's present interpretation of its rules, namely, that compliance with rule 34b–1 does not relieve the fund, underwriter, or dealer of the obligation to ensure that sales literature is not false or misleading. This added language merely confirms the present state of the law and imposes no additional burden hours.[138]

[135] See discussion in note 134, *supra.*

[136] See discussion in note 134, *supra.*

[137] Based on its analysis of data from the EDGAR filing system from 2000–2001, the Commission estimates that there are approximately 200 variable life insurace policies, with respect to which as least one post-effective amendment must be filed per year. In addition, the Commission estimates, also based on EDGAR filing data, that 300 additional post-effective amendments are filed for these variable life insurance policies each year, generally to make no-material changes to their registration statements.

[138] The secondary effect on the burden attributable to rule 34b–1 due to the proposed amendments to rule 482 is estimated to be negligible. Both before and after the proposed amendments, rule 34b–1 would require any performance data included in supplemental sales literature to be accompanied by performance data computed using the standardized formulas for advertising performance under rule 482. We

Continued

2. Rule 482

Rule 482, including the proposed amendments, contains collection of information requirements in that it permits a fund to advertise information subject to certain disclosure requirements. Compliance with rule 482 is mandatory for every fund that issues rule 482 advertisements. Responses to the disclosure requirements will not be kept confidential.

The Commission estimates that 41,484 responses are filed annually by 5,587 funds pursuant to rule 482. The burden associated with rule 482 is presently included in the collections of information for the investment company registration statement forms, but the Commission is transferring this PRA burden to a new rule 482 collection of information, with an annual burden of 225,015 hours. The proposed amendments to rule 482 would affect this total. The Commission estimates an increase of 4,060 annual burden hours, or 0.727 hours per fund, would be required to comply with the proposed amendments to rule 482, as a result of one-time switchover costs amortized over a three-year period. The Commission also estimates a decrease of 10,950 annual burden hours, or 1.96 hours per fund, resulting from the proposed amendments due to the simplification and clarification of rule 482, including the removal of the ''substance of which'' requirement.[139] The net result would be an annual decrease of approximately 6,890 (4,060 hours increase—10,950 hours decrease) hours.

D. Request for Comments

We request your comments on the accuracy of our estimates. Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments to: (i) Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility; (ii) evaluate the accuracy of the Commission's estimate of burden of the proposed collections of information; (iii) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (iv) evaluate whether there are ways to minimize the burden of the collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Persons submitting comments on the collection of information requirements should direct the comments to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Room 3208, New Executive Office Building, Washington, DC 20503, and should send a copy to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 5th Street, NW, Washington, DC 20549–0609, with reference to File No. S7–17–02. Request for materials submitted to OMB by the Commission with regard to this collection of information should be in writing, refer to File No. S7–17–02, and be submitted to the Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549, Attention: Records Management, Office of Filings and Information Services. OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication of this release. Consequently, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days after publication of this Release.

VII. Initial Regulatory Flexibility Analysis

This Initial Regulatory Flexibility Analysis (''Analysis'') has been prepared in accordance with 5 U.S.C. 603, and relates to the Commission's proposed rule and form amendments under the Securities Act of 1933 and the Investment Company Act of 1940 to provide investment companies with the ability to disclose more timely information in advertisements and to reinforce the antifraud protections that apply to investment company advertisements. The proposed amendments would implement a provision of NSMIA by eliminating the requirement in rule 482 under the Securities Act that investment company advertisements contain only information the ''substance of which'' is included in the statutory prospectus. The proposed amendments also would require enhanced disclosure in investment company advertisements and are designed to encourage advertisements that convey balanced information to prospective investors, particularly with respect to past performance. In light of the proposed amendments to rule 482, the Commission is also proposing to rescind the provisions in rule 134 under the Securities Act that apply to investment companies.

A. Reasons for, and Objectives of, Proposed Amendments

The Commission has proposed the amendments to the advertising regulations described above to achieve two separate objectives. First, the Commission intends to simplify and clarify the rules governing fund advertising. Specifically, the proposed amendments would remove the ''substance of which'' requirement of rule 482 and rescind the provisions of rule 134 that apply to investment companies, following Congress' directive in NSMIA to adopt rules or regulations allowing funds the use of a section 10(b) prospectus that may include information the substance of which is not included in the statutory prospectus.[140] We are also proposing technical amendments to reorganize and clarify the language of rule 482. These simplifying and clarifying amendments are intended to aid funds and others in understanding and complying with the advertising rules, making it easier and cheaper for funds to advertise.

Second, the Commission intends to enhance the disclosure required in rule 482 advertising. Specifically, we propose to require advertisements to (i) highlight the availability of certain additional information, such as charge and expense information and updated monthly performance figures; (ii) provide an amended warning legend; and (iii) present certain required disclosure with equal prominence as the major portion of the advertisement. We are proposing these amendments because of our concern about fund performance advertising that could create unrealistic investor expectations or mislead potential investors. The enhanced disclosure requirements are intended to encourage advertisements that are clear, easy to use, and balanced, and to make investors aware of important and timely information necessary to make informed investment decisions.

B. Legal Basis

We are proposing amendments to rule 134 pursuant to authority set forth in sections 2(a)(10) and 19(a) of the Securities Act. We are proposing amendments to rule 156 pursuant to authority set forth in section 19(a) of the

estimate that the changes in types of disclosure and presentation that would be required by the amendments to rule 482 would not affect the amount of review necessary for funds to ensure compliance with rule 34b–1. Therefore, all changes in burden associated with the proposed amendments are accounted for under the category associated with the principal rule generating the burden, *i.e.*, the new rule 482 collection of information.

[139] The estimates of the changes in the hours attributable to rule 482 are based on information supplied to the Commission staff by members of the mutual fund and variable insurance products industry.

[140] National Securities Markets Improvement Act, *supra* note 7.

Securities Act and sections 10(b) and 23(a) of the Exchange Act. We are proposing amendments to rule 482 pursuant to authority set forth in sections 5, 10(b), 19(a), and 28 of the Securities Act and sections 24(g) and 38(a) of the Investment Company Act. We are proposing amendments to rule 34b–1 pursuant to authority set forth in sections 34(b) and 38(a) of the Investment Company Act. We are proposing amendments to Form N–1A, Form N–3, Form N–4, and Form N–6 pursuant to authority set forth in sections 5, 6, 7, 10, and 19(a) of the Securities Act and sections 8, 24(a), 30, and 38 of the Investment Company Act.

C. Small Entities Subject to the Rule

For purposes of the Regulatory Flexibility Act, an investment company is a small entity if it, together with other investment companies in the same group of related investment companies, has net assets of $50 million or less as of the end of its most recent fiscal year.[141] Approximately 225 out of 5587 investment companies meet this definition.[142]

The Commission estimates, based on the staff's discussions with members of the fund industry, that approximately two-thirds of small entity funds do not advertise and, thus, do not incur any burdens or costs associated with rule 482. For small entity funds that do advertise, the Commission estimates an internal hour burden of approximately 80 hours per small entity fund. This represents approximately 6,000 (80 hours × 75 small entities) hours, or $246,915 (6,000 hours × $40.986 wage rate) in internal costs, for all small entities. The Commission estimates that the external cost burden associated with rule 482 for small entities, as with other funds, is negligible. To the extent small entities currently advertise, the burden and costs may affect them to a greater extent because small entities are unable to take advantage of economies of scale available to larger fund complexes.[143]

D. Reporting, Recordkeeping, and Other Compliance Requirements

The proposed amendments would modify the disclosure requirements applicable to rule 482 advertisements. Advertisements would have to contain an amended warning legend, an explanation about where charges and expense information could be found, and, if performance figures are used, information about where updated performance information could be found. In addition, the required disclosure would have to be given as much prominence in the advertisement as the major portion of the advertisement. The proposed amendments would also rescind the disclosure requirements of rule 134 as they apply to funds, but we expect that this would not result in any appreciable change in the disclosure that funds make in their advertisements because present rule 134 advertisements would become rule 482 advertisements.

After assessing the proposed amendments in light of the current reporting requirements and consulting with representatives in the industry, the Commission has considered the potential effect that the proposed amendments would have on the preparation of advertisements. Without regard to the size of the entity, we estimate that the proposed amendments would result in a net decrease of 1.23 hours, or $50.41 (1.23 hours × $40.986 wage rate), per investment company per year in internal costs and a net increase of $805.67 per investment company per year in external costs.[144]

The Commission estimates some one-time switchover costs and burdens that would be imposed on all funds, but which may have a relatively greater impact on smaller firms. These costs include the costs of altering existing advertisements, including those now covered by rule 134, to comply with the new provisions of rule 482; generating performance figures on a monthly basis; and making available the updated monthly performance data by a toll-free telephone number. The costs of making updated performance data available could include expenses for computer time, legal and accounting fees, information technology staff, and additional computer and telephone equipment. However, we believe, based on consultation with a number of fund complexes, that many investment companies that presently advertise already provide performance information on a basis at least as current as monthly through these means and, therefore, that the marginal cost increases for most funds are expected to be minimal.

The Commission anticipates that the proposed amendments would also provide ongoing reductions in the compliance burden for all funds by clarifying the language of rule 482, eliminating the ''substance of which'' requirement, and consolidating fund advertising into one rule. These changes would effect savings primarily by reducing the time and money funds now spend on legal review and amending their SAIs to comply with the ''substance of which'' requirement in current rule 482.

The Commission solicits comment on the effect the proposed amendments would have on small entities.

E. Duplicative, Overlapping or Conflicting Federal Rules

There are no rules that duplicate, overlap, or conflict with the proposed amendments.

F. Significant Alternatives

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish our stated objective, while minimizing any significant adverse impact on small issuers. In connection with the proposed amendments, the Commission considered the following alternatives: (i) The establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (ii) the clarification, consolidation, or simplification of compliance and reporting requirements under the proposed amendments for small entities; (iii) the use of performance rather than design standards; and (iv) an exemption from coverage of the proposed amendments, or any part thereof, for small entities.

The Commission believes at the present time that special compliance or reporting requirements for small

[141] 17 CFR 270.0–10.

[142] This estimate is based on figures compiled by the Commission staff regarding investment companies registered on Form N–1A, Form N–2, Form N–3, Form N–4, and Form S–6. Form S–6 is the form currently used by insurance company separate accounts registered as unit investment trusts and that offer variable life insurance policies to register their securities under the Securities Act. It will be replaced by new Form N–6. *See* Investment Company Act Release No. 25522, *supra* note 89. In determining whether an insurance company separate account is a small entity for purposes of the Regulatory Flexibility Act, the assets of insurance company separate accounts are aggregated with the assets of their sponsoring insurance companies. Investment Company Act rule 0–10(b) [17 CFR 270.0–10(b)]. Currently, no insurance company separate account filing on Form N–3, Form N–4, or Form S–6 qualifies as a small entity.

[143] We note, however, that to the extent that the proposed amendments actually reduce the regulatory burden of advertising, small entities may be encouraged to increase their advertising activity.

[144] These figures are based on the Commission staff's discussions with several fund complexes, and represent the net of the switchover internal hour burdens (12,180 hours (or 4,060 amortized)) and external costs ($13,503,779 (or $4,501,259.67 amortized)), amortized over 3 years, and the annual internal hour burden savings (10,950), which would be attributable to the proposed amendments.

The net annual hour savings would be 6,890 hours (4,060 amortized increase—10,950 annual decrease) or 1.23 hours per investment company (6,890 hours/5,587 investment companies). The annual external costs would be $805.67 per investment company ($4,501,259.67/5,587 investment companies).

entities, or an exemption from coverage for small entities, would not be appropriate or consistent with investor protection. The proposed disclosure amendments would provide shareholders and the public with more balanced information about a fund's performance. Different disclosure requirements for small entities, such as reducing the level of disclosure that small entities would have to provide shareholders in advertising, may create the risk that shareholders would not receive balanced information about a fund's performance or would receive confusing, false, or misleading information. In addition, applying different standards for advertising by small and large funds might impede investors' ability to adequately compare funds. We believe it is important for the enhanced advertising disclosure that would be required by the proposed amendments to be provided to investors by all funds, not just funds that are not considered small entities.

The Commission also notes that current advertising requirements, and its disclosure rules in general, do not distinguish between small entities and other funds. In addition, we believe that it would be inappropriate to impose a different timetable on small entities for complying with the requirements.

The proposed amendments would also reduce the internal regulatory burden on all funds, including small entities, by eliminating the ''substance of which'' requirement from rule 482 and rescinding rule 134 provisions that apply to funds, thereby consolidating and simplifying the advertising rules. Small entities should benefit from these amendments to the same degree as other investment companies. Further clarification, consolidation, or simplification of the proposals for funds that are small entities may be inconsistent with investor protection. Finally, we do not consider using performance rather than design standards to be consistent with our statutory mandate of investor protection in the present context.

G. Solicitation of Comments

The Commission encourages the submission of written comments with respect to any aspect of this Analysis. Comment is specifically requested on the number of small entities that would be affected by the proposed amendments and the likely impact of the proposals on small entities. Commenters are asked to describe the nature of any impact and provide empirical data supporting the extent of the impact. These comments will be considered in the preparation of the Final Regulatory Flexibility Analysis if the proposed amendments are adopted, and will be placed in the same public file as comments on the proposed amendments themselves. Comments should be submitted in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549–0609. Comments also may be submitted electronically at the following E-mail address: *rule-comments@sec.gov.* All comment letters should refer to File No. S7–17–02; this file number should be included on the subject line if E-mail is used. Comment letters will be available for public inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, NW, Washington, DC 20549–0102. Electronically submitted comment letters also will be posted on the Commission's Internet web site (*http://www.sec.gov*).[145]

VIII. Consideration of Impact on the Economy

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 (''SBREFA''),[146] a rule is ''major'' if it results or is likely to result in:

- An annual effect on the economy of $100 million or more;
- Aa major increase in costs or prices for consumers or individual industries; or
- Significant adverse effects on competition, investment, or innovation.

The Commission requests comment on the potential impact of the proposed amendments on the U.S. economy on an annual basis. Commenters are requested to provide empirical data to support their views.

IX. Statutory Authority

The Commission is proposing amendments to rule 134 pursuant to authority set forth in sections 2(a)(10) and 19(a) of the Securities Act [15 U.S.C. 77b(a)(10) and 77s(a)]. The Commission is proposing amendments to rule 156 pursuant to authority set forth in section 19(a) of the Securities Act [15 U.S.C. 77s(a)] and sections 10(b) and 23(a) of the Exchange Act [15 U.S.C. 78j(b) and 78w(a)]. The Commission is proposing amendments to rule 482 pursuant to authority set forth in sections 5, 10(b), 19(a), and 28 of the Securities Act [15 U.S.C. 77e, 77j(b), 77s(a), and 77z–3] and sections 24(g) and 38(a) of the Investment Company Act [15 U.S.C. 80a–24(g) and 80a–37(a)]. The Commission is proposing amendments to rule 34b–1 pursuant to authority set forth in sections 34(b) and 38(a) of the Investment Company Act [15 U.S.C. 80a–33(b) and 80a–37(a)]. The Commission is proposing amendments to Form N–1A, Form N–3, Form N–4, and Form N–6 pursuant to authority set forth in sections 5, 6, 7, 10, and 19(a) of the Securities Act [15 U.S.C. 77e, 77f, 77g, 77j, and 77s(a)] and sections 8, 24(a), 30, and 38 of the Investment Company Act [15 U.S.C. 80a–8, 80a–24(a), 80a–29, and 80a–37].

List of Subjects

17 CFR Part 230

Advertising, Investment companies, Reporting and recordkeeping requirements, Securities.

17 CFR Part 239

Reporting and recordkeeping requirements, Securities.

17 CFR Parts 270 and 274

Investment companies, Reporting and recordkeeping requirements, Securities.

Text of Proposed Rule and Form Amendments

For the reasons set out in the preamble, the Commission proposes to amend Title 17, Chapter II, 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 as follows:

Authority: 15 U.S.C. 77b, 77c, 77d, 77f, 77g, 77h, 77j, 77r, 77s, 77z–3, 77sss, 78c, 78d, 78j, 78*l*, 78m, 78n, 78o, 78t, 78w, 78*ll*(d), 78mm, 79t, 80a–8, 80a–24, 80a–28, 80a–29, 80a–30, and 80a–37, unless otherwise noted.

* * * * *

2. Section 230.134 is amended by:

a. Removing the authority citation following § 230.134;

b. Revising the introductory text of § 230.134;

c. Removing paragraphs (a)(3)(iii), (a)(13), and (e);

d. Redesignating paragraphs (a)(3)(iv) and (a)(14) as paragraphs (a)(3)(iii) and (a)(13), respectively; and

e. In newly redesignated paragraph (a)(13)(ii), revising the reference ''(a)(14)(i)'' to read ''(a)(13)(i)''.

The revision reads as follows:

§ 230.134 Communications not deemed a prospectus.

The term *prospectus* as defined in section 2(a)(10) of the Act (15 U.S.C. 77b(a)(10)) does not include a notice,

[145] We do not edit personal, identifying information, such as names or e-mail addresses, from electronic submissions. Submit only information that you wish to make publicly available.

[146] Pub. L. No. 104–21, Title II, 110 Stat. 857 (1996).

circular, advertisement, letter, or other communication published or transmitted to any person after a registration statement has been filed if it contains only the statements required or permitted by this § 230.134. This § 230.134 does not apply to a notice, circular, advertisement, letter, or other communication relating to an investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a–1 *et seq.*) or a business development company as defined in section 2(a)(48) of the Investment Company Act (15 U.S.C. 80a–2(a)(48)).

* * * * *

3. Section 230.156 is amended by:

a. Removing the authority citation following § 230.156; and

b. Revising paragraph (b)(2)(i) to read as follows:

§ 230.156 Investment company sales literature.

* * * * *

(b) * * *

(2) * * *

(i) Portrayals of past income, gain, or growth of assets convey an impression of the net investment results achieved by an actual or hypothetical investment which would not be justified under the circumstances, including portrayals that omit explanations, qualifications, limitations, or other statements necessary or appropriate to make the portrayals not misleading; and

* * * * *

4. Section 230.482 is revised to read as follows:

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

(a) *Scope of rule.* This section applies to an advertisement or other sales material (advertisement) with respect to securities of an investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a–1 *et seq.*) (1940 Act), or a business development company, that is selling or proposing to sell its securities pursuant to a registration statement that has been filed under the Act. This section does not apply to an advertisement that is excepted from the definition of prospectus by section 2(a)(10) of the Act (15 U.S.C. 77b(a)(10)), or a Profile under § 230.498. An advertisement that complies with this section, which may include information the substance of which is not included in the prospectus specified in section 10(a) of the Act (15 U.S.C 77j(a)), 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)).

Note to paragraph (a): The fact that an advertisement complies with this section does not relieve the investment company, underwriter, or dealer of the obligation to ensure that the advertisement is not false or misleading. For guidance about factors to be weighed in determining whether statements, representations, illustrations, and descriptions contained in investment company advertisements are misleading, *see* § 230.156. In addition, an advertisement that complies with this section is subject to the legibility requirements of § 230.420.

(b) *Required disclosure.* This paragraph describes information that is required to be included in an advertisement in order to comply with this section.

(1) *Availability of additional information.* An advertisement must include a statement that:

(i) Identifies a source from which an investor may obtain a prospectus; explains that the prospectus contains more complete information about the investment company, including charges and expenses; and states that the prospectus should be read carefully before investing; or

(ii) If used with a Profile, explains that the accompanying Profile contains information about the investment company, including charges and expenses; describes the procedures for investing in the investment company; and indicates the availability of the investment company's prospectus.

(2) *Advertisements used prior to effectiveness of registration statement.* An advertisement that is used prior to effectiveness of the investment company's registration statement or the determination of the public offering price (in the case of a registration statement that becomes effective omitting information from the prospectus contained in the registration statement in reliance upon § 230.430A) must include the ''Subject to Completion'' legend required by § 230.481(b)(2).

(3) *Advertisements including performance data.* An advertisement that includes performance data of an open-end management investment company or a separate account registered under the 1940 Act as a unit investment trust offering variable annuity contracts (trust account) must include the following:

(i) A legend disclosing that the performance data quoted represents past performance; that past performance does not guarantee future results; that the investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost; and that current performance may be lower or higher than the performance data quoted. The legend should also identify a toll-free (or collect) telephone number and, if available, a website where an investor may obtain performance data current to the most recent month-end. An advertisement for a money market fund may omit the disclosure about principal value fluctuation; and

(ii) If a sales load or any other nonrecurring fee is charged, the maximum amount of the load or fee, and if the sales load or fee is not reflected, a statement that the performance data does not reflect the deduction of the sales load or fee, and that, if reflected, the load or fee would reduce the performance quoted.

(4) *Money market funds.* An advertisement for an investment company that holds itself out to be a money market fund must include 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.

A money market fund that does not hold itself out as maintaining a stable net asset value may omit the second sentence of this statement.

(5) *Presentation.* In a print advertisement, the statements required by paragraphs (b)(1) through (b)(4) of this section must be presented in a size type at least as large as and of a style different from, but at least as prominent as, that used in the major portion of the advertisement. In a radio or television advertisement, the statements required by paragraphs (b)(1) through (b)(4) of this section must be given emphasis equal to that used in the major portion of the advertisement. The statements required by paragraph (b)(3) of this section must be presented in close proximity to the performance data, and, in a print advertisement, must be presented in the body of the advertisement and not in a footnote.

(6) *Commission legend.* An advertisement that complies with this section need not contain the Commission legend required by § 230.481(b)(1).

(c) *Use of applications.* An advertisement that complies with this section may not contain or be accompanied by any application by which a prospective investor may invest in the investment company, except that:

(1) *Variable annuity and variable life insurance contracts.* 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 variable annuity or variable life insurance contracts may contain a contract application although the prospectus includes information about an investment company in which the unit investment trust invests that, pursuant to this section, is deemed a prospectus under section 10(b) of the Act (15 U.S.C. 77j(b)); and

(2) *Profile.* An advertisement that complies with this section 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.

(d) *Performance data for non-money market funds.* In the case of an open-end management investment company or a trust account (other than a money market fund referred to in paragraph (e) of this section), any quotation of the company's performance contained in an advertisement shall be limited to quotations of:

(1) *Current yield.* A current yield that:

(i) Is based on the methods of computation prescribed in Form N–1A (§§ 239.15A and 274.11A of this chapter), N–3 (§§ 239.17a and 274.11b of this chapter), or N–4 (§§ 239.17b and 274.11c of this chapter);

(ii) Is accompanied by quotations of total return as provided for in paragraph (d)(3) of this section;

(iii) Is set out in no greater prominence than the required quotations of total return; and

(iv) Adjacent to the quotation and with no less prominence than the quotation, identifies the length of and the date of the last day in the base period used in computing the quotation.

(2) *Tax-equivalent yield.* A tax-equivalent yield that:

(i) Is based on the methods of computation prescribed in Form N–1A (§§ 239.15A and 274.11A of this chapter), N–3 (§§ 239.17a and 274.11b of this chapter), or N–4 (§§ 239.17b and 274.11c of this chapter);

(ii) Is accompanied by quotations of yield as provided for in paragraph (d)(1) of this section and total return as provided for in paragraph (d)(3) of this section;

(iii) Is set out in no greater prominence than the required quotations of yield and total return;

(iv) Relates to the same base period as the required quotation of yield; and

(v) Adjacent to the quotation and with no less prominence than the quotation, identifies the length of and the date of the last day in the base period used in computing the quotation.

(3) *Average annual total return.* Average annual total return for one, five, and ten year periods, except that if the company's registration statement under the Act (15 U.S.C. 77a *et seq.*) has been in effect for less than one, five, or ten years, the time period during which the registration statement was in effect is substituted for the period(s) otherwise prescribed. The quotations must:

(i) Be based on the methods of computation prescribed in Form N–1A (§§ 239.15A and 274.11A of this chapter), N–3 (§§ 239.17a and 274.11b of this chapter), or N–4 (§§ 239.17b and 274.11c of this chapter);

(ii) Be current to the most recent calendar quarter ended prior to the submission of the advertisement for publication;

(iii) Be set out with equal prominence; and

(iv) Adjacent to the quotation and with no less prominence than the quotation, identify the length of and the last day of the one, five, and ten year periods.

(4) *After-tax return.* For an open-end management investment company, average annual total return (after taxes on distributions) and average annual total return (after taxes on distributions and redemption) for one, five, and ten year periods, except that if the company's registration statement under the Act (15 U.S.C. 77a *et seq.*) has been in effect for less than one, five, or ten years, the time period during which the registration statement was in effect is substituted for the period(s) otherwise prescribed. The quotations must:

(i) Be based on the methods of computation prescribed in Form N–1A (§§ 239.15A and 274.11A of this chapter);

(ii) Be current to the most recent calendar quarter ended prior to the submission of the advertisement for publication;

(iii) Be accompanied by quotations of total return as provided for in paragraph (d)(3) of this section;

(iv) Include both average annual total return (after taxes on distributions) and average annual total return (after taxes on distributions and redemption);

(v) Be set out with equal prominence and be set out in no greater prominence than the required quotations of total return; and

(vi) Adjacent to the quotations and with no less prominence than the quotations, identify the length of and the last day of the one, five, and ten year periods.

(5) *Other performance measures.* Any other historical measure of company performance (not subject to any prescribed method of computation) if such measurement:

(i) Reflects all elements of return;

(ii) Is accompanied by quotations of total return as provided for in paragraph (d)(3) of this section;

(iii) In the case of any measure of performance adjusted to reflect the effect of taxes, is accompanied by quotations of total return as provided for in paragraph (d)(4) of this section;

(iv) Is set out in no greater prominence than the required quotations of total return; and

(v) Adjacent to the measurement and with no less prominence than the measurement, identifies the length of and the last day of the period for which performance is measured.

(e) *Performance data for money market funds.* In the case of a money market fund:

(1) *Yield.* Any quotation of the money market fund's yield in an advertisement shall be based on the methods of computation prescribed in Form N–1A (§§ 239.15A and 274.11A of this chapter), N–3 (§§ 239.17a and 274.11b of this chapter), or N–4 (§§ 239.17b and 274.11c of this chapter) and may include:

(i) A quotation of current yield that, adjacent to the quotation and with no less prominence than the quotation, identifies the length of and the date of the last day in the base period used in computing that quotation;

(ii) A quotation of effective yield if it appears in the same advertisement as a quotation of current yield and each quotation relates to an identical base period and is presented with equal prominence; or

(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.

(2) *Total return.* Accompany any quotation of the money market fund's total return in an advertisement with a quotation of the money market fund's current yield under paragraph (e)(1)(i) of this section. Place the quotations of total return and current yield next to each other, in the same size print, and if there is a material difference between the quoted total return and the quoted current yield, include a statement that the yield quotation more closely reflects the current earnings of the money market fund than the total return quotation.

(f) *Advertisements that make tax representations.* An advertisement for an open-end management investment company (other than a company that is permitted under § 270.35d–1(a)(4) of

this chapter to use a name suggesting that the company's distributions are exempt from federal income tax or from both federal and state income tax) that represents or implies that the company is managed to limit or control the effect of taxes on company performance must accompany any quotation of the company's performance permitted by paragraph (d) of this section with quotations of total return as provided for in paragraph (d)(4) of this section.

(g) *Timeliness of performance data.* All performance data contained in any advertisement must be as of the most recent practicable date considering the type of investment company and the media through which the data will be conveyed, except that any advertisement containing total return quotations will be considered to have complied with this paragraph provided that:

(1) The total return quotations are current to the most recent calendar quarter ended prior to the submission of the advertisement for publication; and

(2) Total return quotations current to the most recent month ended three calendar days prior to the date of use are provided at the toll-free (or collect) telephone number identified pursuant to paragraph (b)(3)(i).

(h) *Filing.* An advertisement that complies with this section need not be filed as part of the registration statement filed under the Act.

Note to Paragraph (h): These advertisements, unless filed with NASD Regulation, Inc., are required to be filed in accordance with the requirements of § 230.497.

PART 239—FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

5. The authority citation for part 239 continues to read in part as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z–2, 77sss, 78c, 78*l*, 78m, 78n, 78o(d), 78u–5, 78w(a), 78*ll*(d), 79e, 79f, 79g, 79j, 79*l*, 79m, 79n, 79q, 79t, 80a–8, 80a–24, 80a–26, 80a–29, 80a–30, and 80a–37, unless otherwise noted.

* * * * *

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

6. The authority citation for part 270 continues 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. Section 270.34b–1 is amended by:

a. Revising the reference ''(a)(7) of § 230.482'' in paragraph (a) to read ''(b)(4) of § 230.482'';

b. Revising the reference ''(a)(6) of § 230.482'' in paragraph (b)(1)(i) to read ''(b)(3) of § 230.482'';

c. Revising the reference ''(d)(1)(i) of § 230.482'' in paragraph (b)(1)(ii)(A) to read ''(e)(1)(i) of § 230.482'';

d. Revising the reference ''§ 230.482(d)(1)(iii)'' in paragraph (b)(1)(ii)(B) to read ''§ 230.482(e)(1)(iii)';

e. Revising the reference ''(d)(1)(i) of § 230.482'' in the first sentence of paragraph (b)(1)(ii)(C) to read ''(e)(1)(i) of § 230.482'';

f. Revising the reference ''(e)(3) of § 230.482'' in paragraph (b)(1)(iii)(A) to read ''(d)(3) of § 230.482'';

g. Revising the reference ''(e)(4) of § 230.482'' in paragraph (b)(1)(iii)(B) to read ''(d)(4) of § 230.482'';

h. Revising the reference ''(e)(4) of § 230.482'' in paragraph (b)(1)(iii)(C) to read ''(d)(4) of § 230.482'';

i. Revising the reference ''(e)(1) of § 230.482'' in paragraph (b)(1)(iii)(D) to read ''(d)(1) of § 230.482'';

j. Revising the references ''(e)(2)'' and ''(e)(1) of § 230.482'' in paragraph (b)(1)(iii)(E) to read ''(d)(2)'' and ''(d)(1) of § 230.482'', respectively;

k. Revising the reference ''(e)(3)(ii), (e)(4)(ii)'' in paragraph (b)(3) to read ''(d)(3)(ii), (d)(4)(ii)''; and

l. Adding a note following the introductory text of § 270.34b–1 to read as follows:

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

* * * * *

Note to Introductory Text of § 270.34b–1: The fact that the sales literature includes the information specified in paragraphs (a) and (b) of this section does not relieve the investment company, underwriter, or dealer of the obligation to ensure that the sales literature is not false or misleading. For guidance about factors to be weighed in determining whether statements, representations, illustrations, and descriptions contained in investment company sales literature are misleading, *see* § 230.156 of this chapter.

* * * * *

PART 239—FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

PART 274—FORMS PRESCRIBED UNDER THE INVESTMENT COMPANY ACT OF 1940

8. The authority citation for Part 274 continues to read as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 78c(b), 78*l*, 78m, 78n, 78o(d), 80a–8, 80a–24, 80a–26, and 80a–29, unless otherwise noted.

Note: The text of Forms N–1A, N–3, N–4, and N–6 does not, and these amendments will not, appear in the *Code of Federal Regulations.*

9. Item 21 of Form N–1A (referenced in §§ 239.15A and 274.11A) is amended by:

a. Revising the introductory text of paragraphs (a) and (b); and

b. Removing paragraphs (a)(5) and (b)(7), to read as follows:

Form N–1A

* * * * *

Item 21. Calculation of Performance Data

(a) *Money Market Funds.* Yield quotation(s) for a Money Market Fund included in the prospectus should be calculated according to paragraphs (a)(1)–(4).

* * * * *

(b) *Other Funds.* Performance information included in the prospectus should be calculated according to paragraphs (b)(1)–(6).

* * * * *

10. Item 4 of Form N–3 (referenced in §§ 239.17a and 274.11b) is amended by:

a. Removing Item 4(c); and

b. Redesignating Item 4(d) as Item 4(c).

11. Item 25 of Form N–3 (referenced in §§ 239.17a and 274.11b) is amended by:

a. Removing Instruction 5 to paragraph (a); and

b. Revising paragraphs (a) and (b), and Instruction 6 to paragraph (b)(i), to read as follows:

Form N–3

* * * * *

Item 25. Calculation of Performance Data

(a) *Money Market Accounts.* Yield quotation(s) included in the prospectus for an account or sub-account that holds itself out as a ''money market'' account or sub-account should be calculated according to paragraphs (a)(i)–(ii).

(i) *Yield Quotation.* Based on the 7 days ended on the date of the most recent balance sheet of the Registrant included in the registration statement, calculate the yield by determining the net change, exclusive of capital changes and income other than investment income, in the value of a hypothetical pre-existing account having a balance of one accumulation unit of the account or sub-account at the beginning of the period, subtracting a hypothetical charge reflecting deductions from contractowner accounts, and dividing the difference by the value of the account at the beginning of the base period to obtain the base period return, and then multiplying the base period return by (365/7) with the resulting

yield figure carried to at least the nearest hundredth of one percent.

(ii) *Effective Yield Quotation.* Based on the 7 days ended on the date of the most recent balance sheet of the Registrant included in the registration statement, calculate the effective yield, carried to at least the nearest hundredth of one percent, by determining the net change, exclusive of capital changes and income other than investment income, in the value of a hypothetical pre-existing account having a balance of one accumulation unit of the account or sub-account at the beginning of the period, subtracting a hypothetical charge reflecting deductions from contractowner accounts, and dividing the difference by the value of the account at the beginning of the base period to obtain the base period return, and then compounding the base period return by adding 1, raising the sum to a power equal to 365 divided by 7, and subtracting 1 from the result, according to the following formula:

Effective Yield = $[(\text{Base Period Return} + 1)^{365/7}] - 1$.

Instructions:

* * * * *

(b) *Other Accounts.* Performance information included in the prospectus should be calculated according to paragraphs (b)(i)–(iii).

(i) *Average Annual Total Return Quotation.* For the 1-, 5-, and 10-year periods ended on the date of the most recent balance sheet of the Registrant included in the registration statement, calculate the average annual total return by finding the average annual compounded rates of return over the 1-, 5-, and 10-year periods that would equate the initial amount invested to the ending redeemable value, according to the following formula:

$P(1+T)^n = ERV$

Where:

P = A hypothetical initial payment of $1,000

T = Average annual total return

n = Number of years

ERV = Ending redeemable value of a hypothetical $1,000 payment made at the beginning of the 1-, 5-, or 10-year periods at the end of the 1-, 5-, or 10-year periods (or fractional portion).

Instructions:

* * * * *

6. Total return information in the prospectus need only be current to the end of the Registrant's most recent fiscal year.

(ii) *Yield Quotation.* Based on a 30-day (or one month) period ended on the date of the most recent balance sheet of the Registrant included in the registration statement, calculate yield by dividing the net investment income per accumulation unit earned during the period by the maximum offering price per unit on the last day of the period, according to the following formula:

$$\text{YIELD} = 2\left[\left(\frac{a-b}{cd}+1\right)^6 - 1\right]$$

Where:

a = Dividends and interest earned during the period.

b = Expenses accrued for the period (net of reimbursements).

c = The average daily number of accumulation units outstanding during the period.

d = The maximum offering price per accumulation unit on the last day of the period.

Instructions:

* * * * *

(iii) *Non-Standardized Performance Quotation.* A Registrant may calculate performance using any other historical measure of performance (not subject to any prescribed method of computation) if the measurement reflects all elements of return.

* * * * *

12. Item 4 of Form N–4 (referenced in §§ 239.17b and 274.11c) is amended by:

a. Removing Item 4(b); and

b. Redesignating Item 4(c) as Item 4(b).

13. Item 21 of Form N–4 (referenced in §§ 239.17b and 274.11c) is amended by:

a. Removing Instruction 5 to paragraph (a); and

b. Revising paragraphs (a) and (b), and Instruction 6 to paragraph (b)(i), to read as follows:

Form N–4

* * * * *

Item 21. Calculation of Performance Data

(a) *Money Market Funded Sub-Accounts.* Yield quotation(s) included in the prospectus for an account or sub-account that holds itself out as a ''money market'' account or sub-account should be calculated according to paragraphs (a)(i)–(ii).

(i) *Yield Quotation.* Based on the 7 days ended on the date of the most recent balance sheet of the Registrant included in the registration statement, calculate the yield by determining the net change, exclusive of capital changes and income other than investment income, in the value of a hypothetical pre-existing account having a balance of one accumulation unit of the account or sub-account at the beginning of the period, subtracting a hypothetical charge reflecting deductions from contractowner accounts, and dividing the difference by the value of the account at the beginning of the base period to obtain the base period return, and then multiplying the base period return by (365/7) with the resulting yield figure carried to at least the nearest hundredth of one percent.

(ii) *Effective Yield Quotation.* Based on the 7 days ended on the date of the most recent balance sheet of the Registrant included in the registration statement, calculate the effective yield, carried to at least the nearest hundredth of one percent, by determining the net change, exclusive of capital changes and income other than investment income, in the value of a hypothetical pre-existing account having a balance of one accumulation unit of the account or sub-account at the beginning of the period, subtracting a hypothetical charge reflecting deductions from contractowner accounts, and dividing the difference by the value of the account at the beginning of the base period to obtain the base period return, and then compounding the base period return by adding 1, raising the sum to a power equal to 365 divided by 7, and subtracting 1 from the result, according to the following formula:

Effective Yield = $[(\text{Base Period Return} + 1)^{365/7}] - 1$.

Instructions:

* * * * *

(b) *Other Sub-Accounts.* Performance information included in the prospectus should be calculated according to paragraphs (b)(i)–(iii).

(i) *Average Annual Total Return Quotation.* For the 1-, 5-, and 10-year periods ended on the date of the most recent balance sheet of the Registrant included in the registration statement, calculate the average annual total return by finding the average annual compounded rates of return over the 1-, 5-, and 10-year periods that would equate the initial amount invested to the ending redeemable value, according to the following formula:

$P(1+T)^n = ERV$

Where:

P = A hypothetical initial payment of $1,000

T = Average annual total return

n = Number of years

ERV = Ending redeemable value of a hypothetical $1,000 payment made at the beginning of the 1-, 5-, or 10-year periods at the end of the 1-, 5-, or 10-year periods (or fractional portion).

Instructions:

* * * * *

6. Total return information in the prospectus need only be current to the end of the Registrant's most recent fiscal year.

(ii) *Yield Quotation.* Based on a 30-day (or one month) period ended on the date of the most recent balance sheet of the Registrant included in the registration statement, calculate yield by dividing the net investment income per accumulation unit earned during the period by the maximum offering price per unit on the last day of the period, according to the following formula:

$$YIELD = 2\left[\left(\frac{a-b}{cd}+1\right)^{6}-1\right]$$

Where:

a = Net investment income earned during the period by the portfolio company attributable to shares owned by the sub-account.

b = Expenses accrued for the period (net of reimbursements).

c = The average daily number of accumulation units outstanding during the period.

d = The maximum offering price per accumulation unit on the last day of the period.

Instructions:

* * * * *

(iii) *Non-Standardized Performance Quotation.* A Registrant may calculate performance using any other historical measure of performance (not subject to any prescribed method of computation) if the measurement reflects all elements of return.

* * * * *

14. General Instruction B.2.(b) of Form N–6 (referenced in §§ 239.17c and 274.11d) is amended by revising the reference ''Items 27 (c), (k), (l), (n), and (o)'' to read ''Items 26 (c), (k), (l), (n), and (o)''.

15. Item 25 of Form N–6 (referenced in §§ 239.17c and 274.11d) is removed.

16. Form N–6 (referenced in §§ 239.17c and 274.11d) is further amended by:

a. Redesignating Items 26 through 34 as Items 25 though 33;

b. Revising the reference ''Item 26'' in paragraph (j) of newly redesignated Item 25 to read ''Item 25'' and

c. Revising the reference ''Item 26'' in paragraphs (l) and (m) of newly redesignated Item 26 to read ''Item 25''.

By the Commission.

Dated: May 17, 2002.

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 02–12893 Filed 5–23–02; 8:45 am]

BILLING CODE 8010–01–P