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U.S. House of Representatives
 Committee on Energy and Commerce
 Room 2125, Rayburn House Office Building
 Washington, DC 20515-6115

April 19, 1993

ALAN J. BOTH, STAFF DIRECTOR AND CHIEF COUNSEL
 DENNIS B. FITZGIBBONS, DEPUTY STAFF DIRECTOR

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The Honorable Richard C. Breeden
 Chairman
 Securities and Exchange Commission
 450 Fifth Street, N.W.
 Washington, D.C. 20549

Legislative Affairs
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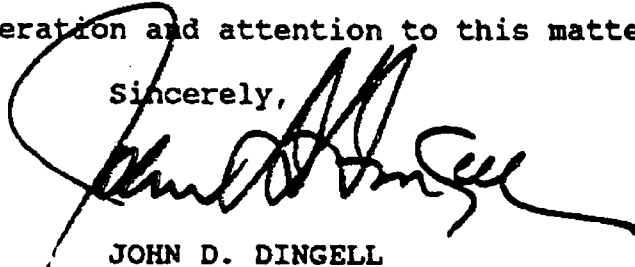
Dear Chairman Breeden:

Pursuant to Rules X and XI of the U.S. House of Representatives, and our continuing oversight of securities and exchanges, we are looking into press reports (enclosure) that your agency recently "wiped most of the rules on mutual fund advertising off its books." If true, this is a troubling development, given the increased scrutiny being given to advertising and sales of mutual funds by banks.

Please provide the Committee with a full report on this matter, including copies of relevant Commission releases.

Thank you your cooperation and attention to this matter.

Sincerely,



JOHN D. DINGELL
 CHAIRMAN

Enclosure

cc: The Honorable Edward J. Markey
 The Honorable Carlos J. Moorhead
 The Honorable Jack Fields

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 230, 239, and 274

[Release Nos. 33-6982, IC-19342, File No. S7-11-93]

RIN: 3235-AF58

Off-the-Page Prospectuses for Open-End Management Investment Companies

AGENCY: Securities and Exchange Commission

ACTION: Proposed amendments to rule and form, proposed form, and request for comment.

SUMMARY: The Commission is proposing for public comment an amendment to a rule under the Securities Act of 1933 (the "Securities Act") to permit certain advertisements ("off-the-page prospectuses") for shares of open-end management investment companies ("mutual funds") to include an order form if the off-the-page prospectuses contain specified disclosure. The Commission also is proposing for public comment a new form, which would be a cover sheet for certain filings required to be made under the proposed rule amendments. Currently, investors in funds that are marketed directly to the public must wait to receive a longer prospectus, while investors who purchase fund shares through sales representatives may purchase directly, without delay. Under the proposed rule changes, investors in direct marketed funds would be able to make their investments more quickly by purchasing shares directly ("off-the-page") from off-the-page prospectuses. This change also would level somewhat a disparity that exists between direct marketed funds and funds that sell through commissioned sales representatives. This change also should promote increased dissemination of information about mutual funds and reduce total marketing costs for some funds.

DATES: Comments must be received on or before (ninety days after date of publication in the *Federal Register*).

ADDRESSES: Comments should be submitted in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 5th Street, N.W., Stop 6-9, Washington, D.C.

20549. All comment letters should refer to File No. S7-11-93. All comments received will be available for public inspection and copying in the Commission's Public Reference Room, 450 5th Street, N.W., Washington, D.C. 20549.

FOR FURTHER INFORMATION CONTACT: Diane C. Blizzard, Assistant Director, or Robert G. Bagnall, Special Counsel, (202) 272-2048, Office of Regulatory Policy, Division of Investment Management, Securities and Exchange Commission, Mail Stop 10-6, 450 5th Street, N.W., Washington, D.C. 20549.

SUPPLEMENTARY INFORMATION: The Commission today is requesting public comment on proposed rule 482(g) [17 CFR 230.482(g)] under the Securities Act of 1933 [15 U.S.C. §§ 77a - 77aa] (the "Securities Act"). Proposed rule 482(g) would implement a recommendation made in the report issued last year by the Division of Investment Management, *Protecting Investors: A Half Century of Investment Company Regulation* (the "Protecting Investors report"), in Chapter 9, Investment Company Advertising.¹ Proposed Form 482(g) would be used to file definitive copies of off-the-page prospectuses with the Commission, and to request advance review by the Commission of certain off-the-page prospectuses. In addition, the Commission is proposing to delete the instructions for summary prospectuses for open-end management investment companies now contained in Form N-1A.

EXECUTIVE SUMMARY

The Commission is proposing to amend rule 482 under the Securities Act by adding new paragraph (g), which would permit inclusion of order forms in mutual fund advertisements containing specified disclosure. This change would allow investors the option of purchasing mutual fund shares "off-the-page" directly from certain special "off-the-page prospectuses" by completing order forms included with those prospectuses.

¹PROTECTING INVESTORS: A HALF CENTURY OF INVESTMENT COMPANY REGULATION, Chapter 9, *Investment Company Advertising* 347-71 (1992).

Currently, investors in direct marketed funds must wait to receive a longer prospectus that meets the requirements of section 10(a) of the Securities Act,² while investors who purchase from commissioned sales representatives may purchase directly, without delay. The new procedure would give investors in direct marketed funds the same option that investors now have only through commissioned sales persons, although the rule would require that off-the-page prospectuses provide core information.

Because off-the-page prospectuses would be required to contain significantly more disclosure than generally appears today in mutual fund advertisements, these changes should promote increased dissemination of information about mutual funds. The off-the-page prospectus would be required to contain critical information about the fund, such as risks, levels of fees and expenses, investment objectives and policies, and historical performance data. Off-the-page prospectuses would carry liability under section 12(2) of the Securities Act for misstatements or omissions of material fact.³ They would also be subject to the anti-fraud provisions of section 17(a) of the Securities Act and section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), including rule 10b-5.⁴ Rule 482(g) would not permit the use of off-the-page prospectuses in radio, television, or other broadcast or electronic media, but would permit their use in direct mail, as well as in newspapers, magazines, and other print media.

Rule 482(g) would require off-the-page prospectuses to include legends alerting investors that a section 10(a) prospectus is available and contains more information. Those investors who choose to review the section 10(a) prospectus before investing would be able to request the section 10(a) prospectus by making a telephone call or by checking a box on

²15 U.S.C. § 77j(a).

³15 U.S.C. § 77l(2).

⁴15 U.S.C. § 77q(a); Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. §§ 78a-78ll, 78j(b); 17 CFR 240.10b-5.

the order form. The fund would still be required to deliver the section 10(a) prospectus to investors before, or with, the confirmation of the sale.

With limited exceptions, off-the-page prospectuses would be subject to the other requirements of rule 482, including the standards for computing and presenting performance data. Each fund relying on rule 482(g) would be required to submit its proposed off-the-page prospectuses for advance review by the staff of the National Association of Securities Dealers, Inc. ("NASD") (for its members) or the Commission (for non-NASD members) for a one year period beginning with the first use of an off-the-page prospectus for the shares that are being offered.

Proposed rule 482(g) does not represent any change in the Commission's views on advertising or other publicity for issuers other than mutual funds.

I. BACKGROUND

A. Mutual Fund Advertising

Advertising by investment companies, especially mutual funds, is subject to considerations that generally do not apply to other issuers of securities. Due to these differences, investment companies encounter difficulties under the Securities Act provisions that restrict the advertisement of information regarding securities being sold in a public offering. Because of the nature of their business, the effect of the advertising restrictions is more severe for investment companies than for other types of companies. Other companies, even when engaged in a public offering, are able to advertise their products,¹ and thus gain name recognition with potential investors, because advertising that does not attempt to sell

¹Of course, information and publicity disseminated about *any* issuer during a public offering could be deemed to be a step in the selling process and constitute an offer, depending on the facts and circumstances surrounding each case. *See, e.g.,* Guidelines for the Release of Information by Issuers Whose Securities are in Registration, Securities Act Release No. 5180 (Aug. 16, 1971), 36 FR 16506; Publication of Information Prior To or After the Filing and Effective Date of a Registration Statement Under the Securities Act of 1933, Securities Act Release No. 5009 (Oct. 7, 1969), 34 FR 16870; Publication of Information Prior To or After the Effective Date of a Registration Statement, Securities Act Release No. 3844 (Oct. 8, 1957), 22 FR 8359.

securities is not subject to the Securities Act. Investment companies, in contrast, do not sell products in the usual commercial sense. The very nature of an investment company is so inextricably tied to the securities it offers that almost any advertisement about the company is potentially an offer to sell its securities that must conform to the Securities Act's requirements.⁶ Thus, absent an exception, any advertisement about an investment company is a prospectus within section 2(10) of the Securities Act,⁷ and its use is subject to the requirements of sections 5 and 10 of the Securities Act.⁸

The advertising restrictions of the Securities Act cause special problems for mutual funds, because they continuously offer and sell their shares to provide a steady stream of capital into their portfolios and to enable them to meet redemption requests from outgoing shareholders. These ongoing distribution practices contrast sharply with more traditional underwritings, which raise fixed amounts of capital through periodic offerings of limited duration. With traditional underwritings, the advertising restrictions end with the offering. With mutual funds, the advertising restrictions never end because the offering process, in effect, never ends.

Accordingly, the Securities Act rules treat investment company advertisements differently than the advertisements of other issuers. Rule 134 under the Securities Act, which excepts "tombstone" advertisements from the definition of prospectus, contains express provisions that are applicable only to registered investment companies.⁹ Rule 482, which provides that certain investment company advertisements are omitting "prospectuses"

⁶Section 2(3) of the Securities Act defines the term "offer" to include every attempt to 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(3). See also, e.g., In the Matter of Carl M. Loeb, Rhodes & Co., 38 S.E.C. 843, 848 (1950) (holding that the statutory definitions of "offer" and "prospectus" are intentionally broad so as to include any document designed to procure offers for a security).

⁷15 U.S.C. § 77b(10).

⁸15 U.S.C. §§ 77e, 77j.

⁹17 CFR 230.134(a)(3)(iii). (a)(13).

under section 10(b) of the Securities Act, is available only to registered investment companies and business development companies.¹⁰ The summary prospectus rule likewise exempts mutual funds from some of the requirements applicable to other issuers.¹¹

The current advertising restrictions under the Securities Act also treat direct marketed funds differently than funds sold through broker networks. Direct marketed funds use print, radio, and television advertising almost exclusively to sell fund shares to investors, while funds sold through a commissioned sales force employ sales personnel who sell fund shares orally. Over the past two decades, direct marketed funds have come to represent a significant part of mutual fund distribution. In 1990, direct marketed funds had sales of \$82.6 billion, or thirty-five percent of stock, bond, and income fund sales, while funds sold through a sales force had sales of \$140.1 billion, or sixty percent;¹² in 1970, no-load funds, including both direct marketed funds and institutional funds, represented only eleven percent of total fund sales.¹³ The advertising restrictions of the Securities Act have a much greater impact on direct marketed funds than on funds sold through a commissioned sales force because the Securities Act does not hold the oral representations of sales personnel to the same prospectus requirements as it does certain written communications.¹⁴

¹⁰17 CFR 230.482. Section 10(b) of the Securities Act authorizes the Commission to adopt rules and regulations permitting securities to be offered and sold by means of a prospectus which omits in part, or summarizes, information set forth in a preliminary prospectus or the final prospectus complying with section 10(a) of the Securities Act.

¹¹17 CFR 230.431. Investment companies are excepted from the requirements of paragraphs (a)(1) through (a)(4).

¹²INVESTMENT COMPANY INSTITUTE, MUTUAL FUND FACT BOOK: INDUSTRY TRENDS AND STATISTICS FOR 1991 42-43 (32d ed. 1992).

¹³INVESTMENT COMPANY INSTITUTE, 1972 MUTUAL FUND FACT BOOK 72 (1973).

¹⁴Oral representations are subject to the liability provisions of section 12(2) of the Securities Act, but not to the provisions of section 11 (15 U.S.C. § 77k), which applies to section 10(a) prospectuses because they are part of the registration statement. See *infra* notes 22, 44 and 46, and accompanying text.

B. Prohibition of Order Form in Rule 482 Advertisements

The chief difference in the requirements for broker sold funds and direct marketed funds is that rule 482 prohibits an application form from accompanying an advertisement under rule 482.¹⁵ Thus, potential investors in direct marketed funds may not purchase shares directly from an advertisement; instead, they first must request and receive a section 10(a) prospectus before they may purchase shares of a fund. Rule 482 also contains requirements for a legend encouraging the investor to request and read the section 10(a) prospectus before investing, as well as information on how to obtain a section 10(a) prospectus.

It is possible, however, and is perhaps the typical case under the Securities Act, to sell a security orally and to send the section 10(a) prospectus later, either with the security or the confirmation of the sale (whichever is earlier). Section 5(b)(1) limits only the use of a prospectus, and "prospectus" is defined to include written -- but not oral -- communications.¹⁶ Sales representatives who offer orally, either in person or over the telephone, are permitted to deliver the section 10(a) prospectus after an investor has made an investment decision.¹⁷ Investors who are interested in purchasing a fund's shares may place

¹⁵The application form, which contains shareholder account information, cannot be sent alone because under section 2(10) it would be an illegal "prospectus" unless preceded or accompanied by the section 10(a) prospectus, and there is no available safe harbor.

¹⁶15 U.S.C. § 77e(b)(1). Section 5(b)(1) makes it unlawful to transmit in interstate commerce any prospectus relating to any security with respect to which a registration statement has been filed, unless the prospectus meets the requirements of section 10. Section 2(10) was amended in 1954 to include television communications within the definition of the term prospectus. Ch. 667, 68 Stat. 683 (1954).

¹⁷The Commission addressed issues raised by oral offers when it began requiring, among other things, the broad distribution of preliminary prospectuses to underwriters and participants in selling groups under rule 460 under the Securities Act (which does not apply to sales of certain investment company securities) and, absent an exception, requiring under rule 15c2-8 under the Exchange Act brokers and dealers in initial public offerings to deliver a preliminary prospectus to any person who is expected to receive a confirmation of sale at least 48 hours prior to the mailing of such confirmation. 17 CFR 230.460; 17 CFR 240.15c2-8. Preliminary prospectuses are less widely used for sales of mutual fund securities because many mutual funds do not begin marketing until after the registration statement becomes effective, and, in any case, the vast majority of offers as well as sales

(continued...)

an order on the day they become interested, without waiting for a section 10(a) prospectus. Thus, many investors do not necessarily receive full, or indeed, any written disclosure before they decide to purchase a security.

Direct marketed funds attract investor interest by advertising in accordance with the requirements of a safe harbor rule such as rule 482.¹⁷ Interested investors must request a section 10(a) prospectus by filling out a request form or by making a telephone call. The section 10(a) prospectus is received days, or perhaps even weeks (depending on when the investor has time to complete the form or make the telephone call), after the investor first becomes interested. Finally, either the customer or the fund must initiate further contact to place the order. This process is expensive and time-consuming.

Other countries permit sales directly, or "off-the-page," from advertisements containing specified information. For example, Rule 7.25 of the British Conduct of Business Rules permits off-the-page advertisements if they contain up to eighteen items of information, along with certain statements, if applicable.¹⁸ These items include information regarding the minimum amounts that can be invested, sales charges, reinvestment options, redemption procedures, investment objectives, expenses, fees, and performance. Although these requirements are quite extensive, and the advertisements can take up one-half of a

¹⁷(...continued)

occur in the post-effective period when preliminary prospectuses are not permitted to be used (because final section 10(a) prospectuses are available).

¹⁸A fund also may advertise under rule 134, the "tombstone" rule, which permits advertisements containing a broad range of information about the fund other than performance information. 17 CFR 230.134. Rule 135a permits generic advertising that contains information about investment companies generally but not about the securities of any particular investment company. 17 CFR 230.135a.

¹⁹See Securities and Investments Board (United Kingdom), the Financial Services (Conduct of Business) Rules 1987, rule 7.25.

page or more of advertising space, the size of the advertisements has not prevented their use in the British press. Similar procedures are available in Hong Kong and the Netherlands.²¹

The Securities Act does not prohibit the inclusion of order forms; the Act only prohibits the delivery of a security or the sending of a confirmation in interstate commerce unless accompanied or preceded by a section 10(a) prospectus.²¹ Thus, the requirements of rule 482 appear to impose unnecessary burdens and delays on investors seeking to invest in direct marketed funds.

II. DISCUSSION

The Commission is proposing to amend rule 482 by adding new paragraph (g), which would permit inclusion of order forms in mutual fund advertisements containing specified disclosure. Those investors who choose to review the section 10(a) prospectus before investing would be able to request the section 10(a) prospectus by making a telephone call or by checking a box on the order form. The off-the-page prospectus would be required to contain critical information about the fund, such as risks, levels of fees and expenses, investment objectives and policies, and historical performance data. The off-the-page prospectus would carry liability under section 12(2) of the Securities Act²² for false or misleading statements of material fact; it also would carry liability under section 17(a) of the Securities Act and section 10(b) of the Exchange Act, including rule 10b-5, for fraud. The

²⁰Supplement 1 to Appendix C, Code on Unit Trusts and Mutual Funds (Hong Kong) (October, 1991). Although apparently there is no rule regarding the use of off-the-page advertisements in the Netherlands, according to conversations between Commission staff and regulators in the Netherlands, off-the-page advertising occurs there because it is not prohibited by any section of their statute, and most funds are direct marketed.

²¹15 U.S.C. § 77e(b)(2).

²²15 U.S.C. § 77i(2). Section 12(2) imposes liability on persons who offer or sell a security in interstate commerce by means of a prospectus or oral communication which includes an untrue statement of material fact, or omits to state a material fact that is necessary under the circumstances in order to make the statements made not misleading, subject to a defense that the offeror/seller did not know and, in the exercise of reasonable care, could not have known, of the untruth or omission.

section 10(a) prospectus still would be required to be delivered to investors before, or with, the confirmation of the sale.

Off-the-page prospectuses should increase the amount and quality of information about mutual funds reaching investors. Because the rule for the first time would require the inclusion of core information in mutual fund advertisements, off-the-page prospectuses -- especially those appearing in the print media -- would provide an additional, widely circulated source of important information that investors could use to make comparative judgments about their investment alternatives. Investors who wish to study the section 10(a) prospectus before making an investment decision would receive it before investing, but investors who choose to purchase off-the-page would receive the section 10(a) prospectus subsequently, along with or preceding written confirmation of the sale. This practice would parallel the current requirements that apply when investors purchase mutual fund shares through brokers, who may sell securities by means of oral, rather than written, communications.²³

A. Eligible Issuers

Under proposed paragraph (g)(1), only mutual funds satisfying certain requirements would be eligible to use off-the-page prospectuses. Thus, while any registered investment company or any business development company that has filed a registration statement may advertise under rule 482, paragraph (g) of rule 482 would not be available to issuers other than mutual funds: *i.e.*, off-the-page prospectuses would not be available for closed-end funds, unit investment trusts, registered separate accounts,²⁴ face amount certificate companies, business development companies, open-end companies that are exempt from

²³See *supra* note 17 and accompanying text.

²⁴Paragraph (g)(1) would limit the use of off-the-page prospectuses to open-end companies with an effective registration statement on Form N-1A. While a few separate accounts are organized as open-end companies, they are not eligible to use Form N-1A. See Form N-1A, General Instruction A.

section 22(e) of the Investment Company Act,²⁵ or issuers other than investment companies. Thus, proposed paragraph (g) does not represent any change in the Commission's views on advertising or other publicity for issuers other than mutual funds.²⁶ In addition, mutual funds that issue multiple classes of stock, or are part of a "hub and spoke" arrangement, would not be eligible to use off-the-page prospectuses due to the complexity of the disclosure that would be necessary to meet the requirements of proposed paragraph (g).²⁷

The limitation to mutual funds is based in part upon their distinct offering practices. Mutual funds generally offer their shares to the public in a continuous offering of an unlimited number of shares; and many funds offer their shares directly through advertisements. By contrast, investment companies other than open-end companies typically use a more traditional type of underwriting in which set amounts of capital are raised by underwriters through periodic offerings of limited duration; and these other investment companies generally do not advertise or market their shares directly to any significant extent. Moreover, rule 482 contains standardized requirements for uniform computation and presentation of mutual fund performance; such requirements do not yet exist for other investment companies. The Commission requests comment, however, on whether other

²⁵15 U.S.C. § 80a-22(e). Thus, if the Commission adopts proposed rule 22e-3 under the Investment Company Act, investment companies relying on that rule would not be able to use off-the-page prospectuses under rule 482(g). See *Periodic Repurchases by Closed-End Management Investment Companies; Redemptions by Open-End Management Investment Companies and Registered Separate Accounts at Periodic Intervals or with Extended Payment*, Securities Act Release No. 6948 (July 28, 1992), 57 FR 34701. In addition, investment companies suspending the right of redemption by other means available under section 22(e) would not be able to use off-the-page prospectuses.

²⁶*Cf.* Investment Company Advertising, Securities Act Release No. 5591 (June 16, 1975), 40 FR 27442 (adoption of amendments to rule 134 for investment companies "is not intended, and should not be construed, to indicate any change in the Commission's views with respect to general publicity concerning other offerings subject to the registration requirements of the Securities Act of 1933").

²⁷The Commission in the future will consider a rule that would codify exemptive relief obtained by companies that issue multiple classes of stock. In connection with that rule, the Commission will consider the types of disclosure that should appear in prospectuses and advertisements of such companies, and may consider whether multiple class companies and companies participating in a "hub and spoke" arrangement should be able to use off-the-page prospectuses.

types of investment companies, such as unit investment trusts or registered separate accounts, should be able to sell off-the-page. Conversely, the Commission requests comment on whether, at least initially, the rule should be limited to certain types of mutual funds that might be regarded as the least complicated, most easily understood, and involving the least risk. For example, should the rule be available only to money market funds?

Limiting the use of off-the-page prospectuses to mutual funds, but not other types of investment companies, also is justified by the vast difference in the amount of information available to retail investors about mutual funds generally and individual funds in particular. Because over one quarter of United States households invest in mutual funds, either directly or indirectly through benefit plans, and the holdings of mutual funds are many times greater than those of closed-end funds, unit investment trusts, or face amount certificate companies,²⁵ a significant portion of the investing public is generally familiar with what mutual funds are and how they operate. In addition, many publications, both financial and general interest, provide a continuous flow of information about mutual funds generally and about specific funds. Moreover, the requirements of the Investment Company Act and its rules impose a high degree of standardization upon mutual funds, and provisions such as the leverage restrictions of section 18 of the Investment Company Act²⁶ limit the kinds of securities that mutual funds may offer. There is not the same degree of familiarity, information, or standardization for other investment companies. Accordingly, it is significantly more likely that off-the-page prospectuses for mutual funds could be designed in a way that adequately protects investors.

Paragraph (g)(1) also would limit the use of off-the-page prospectuses to funds that have been in existence at least two years from the first public sale of their shares. This

²⁵The Commission estimates that, as of December 31, 1992 open-end companies had \$1.6 trillion in assets; closed-end companies \$85.1 billion; unit investment trusts \$111.6 billion; and face amount certificate companies approximately \$4 billion.

²⁶15 U.S.C. § 80a-18.

seasoning period, among other things, would allow the Commission staff opportunities to review the disclosure in a fund's registration statement, which would be the basis for the disclosure in an off-the-page prospectus.³⁰ This period also would provide a financial history on which a fund's performance or other financial data would be based. Moreover, the requirement of a two-year period of operation would increase the likelihood that the financial press and other publications would have provided a flow of information about the fund to the market. The Commission requests comment on this seasoning requirement, in particular on the appropriateness of the length of the two-year period.

Paragraph (g)(1) also requires that a fund intend to comply with Subchapter M of the Internal Revenue Code [26 U.S.C. §§ 851-860] during the coming taxable year so as to avoid taxation at the fund level. A similar requirement currently applies to mutual fund summary prospectuses.³¹ Virtually all mutual funds elect to comply with Subchapter M. This requirement should ensure further uniformity and comparability among the funds eligible to use the off-the-page prospectus provisions. The requirement also should make specific disclosure concerning tax consequences of mutual fund investments unnecessary, except for those funds such as tax-exempt funds whose special tax advantages are material to an investment decision.³²

B. Disclosure

Proposed paragraph (g)(2) would require off-the-page prospectuses to contain disclosure that is critical to an investment decision. The disclosure requirements in paragraph (g)(2) follow the order of the corresponding items in Form N-1A. The

³⁰The PROTECTING INVESTORS report, *supra* note 1, at 361-63, recommends the adoption of a new section 10(g) of the Securities Act, which would permit the Commission to adopt rules for an advertising prospectus. An advertising prospectus would not be limited to summarizing or omitting information contained in the section 10(a) prospectus and hence would not be limited to disclosure the "substance of" which is contained in the section 10(a) prospectus.

³¹See Form N-1A, Instructions as to Summary Prospectuses.

³²See proposed paragraph (g)(2)(vi)(B).

Commission encourages commenters to furnish draft samples of off-the-page prospectuses that show how the proposed disclosure requirements, or any alternatives they may suggest, might work in practice.

Paragraph (g)(2)(i) calls for basic information such as the name of a fund and the type of fund (*e.g.*, money market fund, bond fund, balanced fund, etc.). Subparagraphs (A) and (B) correspond to Items 1(a)(i) and 1(a)(ii) of Form N-1A.

Paragraph (g)(2)(ii) requires disclosure of fees and expenses through inclusion of the fee table called for by Item 2(a)(i) of Form N-1A. In most instances, an off-the-page prospectus should be able to present this information concisely in tabular form. As under the instructions to Item 2(a) of Form N-1A, some brief accompanying text may be necessary to aid comprehension and avoid misleading investors; for example, if advisory or other fees are reduced through waiver, reimbursement, or some other reason, some clarification would be necessary under Instruction 13. The off-the-page prospectus must provide a breakdown of operating expenses in tabular form, as is required under Item 2 of Form N-1A.³³

The Commission requests comment on whether required disclosure of fund operating expenses should be limited to an aggregate expense figure, as the Investment Company Institute has suggested.³⁴ Even if other expense items were not to be listed separately, the Commission believes that rule 12b-1 fees would need to be identified separately in order to

³³The Investment Company Institute (ICI) has proposed requiring only disclosure of total fund operating expenses and not requiring the presentation of such information in tabular form. See The Institute's Submission to Permit the Use of Summary Advertising Prospectuses at 9, enclosed in letter from Craig S. Tyle, Vice President, Investment Company Institute, to Marianne K. Smythe, Director, Division of Investment Management (Oct. 21, 1992) ("ICI Submission"). The ICI argued that the recommendations in the PROTECTING INVESTORS report for a unified fee investment company support disclosure of only the total expense figure. The unified fee proposal, however, relies fundamentally upon the assumption of competition among funds charging a single annual fee, and no separate sales charges, whereas proposed rule 482(g) would not exclude funds charging front-end loads, contingent deferred sales loads, or more than *de minimis* rule 12b-1 fees. Accordingly, the unified fee proposal does not provide a logical basis for limiting required off-the-page prospectus disclosure to total operating expenses. The Commission believes that disclosure in tabular form should not occupy materially more space than narrative disclosure and is necessary to make such disclosure more conspicuous and easier to compare.

³⁴*Id.*

ensure that investors are notified about any fees that they may be paying for distribution expenses.

The Commission requests comment on whether the fee table example required by Item 2(a)(i) of Form N-1A may be deleted from the off-the-page rule. If the example were deleted, what alternative requirement might allow investors to compare the total costs that they would pay in funds with or without front-end or back-end sales charges?

In addition to that disclosure of fees, paragraph (g)(5) would require off-the-page prospectuses for funds that charge front-end or deferred sales loads to include legends that make clear the consequences of such loads. Because such loads are material to investors and generally are not refunded or waived, off-the-page prospectuses would be required to make prominent³⁸ disclosure to investors of how much money will *not* be returned to them or will be charged if they subsequently redeem their investment. Paragraph (g)(5) would require those legends to be modified to the extent that a fund waives or refunds loads for investors who redeem their investment within a specified period after purchase. For such funds, the legend must disclose the terms of such refund or waiver, the possibility that the value of the investment may fluctuate during the waiting period, and the tax consequences of such short-term investment.³⁹

Paragraph (g)(2)(iii) calls for prominent disclosure about a fund's performance. A fund would be required to provide performance data in accordance with paragraphs (d), (e), and (f) of rule 482, and the fund's turnover rate in accordance with Item 3(a) of Form N-1A. The performance data must appear separately in a table or in a box.

³⁸The Division of Investment Management has interpreted a similar requirement to mean that a "statement will be prominent if it appears in some typographically distinctive manner (e.g., boldface, italics, red letters, etc.)." Letter from Carolyn B. Lewis, Assistant Director, Division of Investment Management, SEC. to Registrants at 3-4 (Jan. 17, 1992) (comment II.B).

³⁹See *infra* section II.F for a discussion of such cancellation procedures.

Paragraph (g)(2)(iv) calls for disclosure about a fund's investment objectives, policies, and risks. Apart from the disclosure about fees and performance, this disclosure generally should receive the greatest space and emphasis in an off-the-page prospectus. Funds would have to take care that risk information is in plain English and presented in ways that average investors would readily comprehend. The risk disclosure must be prominent and must appear next to the discussion of investment objectives and policies. Paragraph (g)(2)(iv) also requires disclosure if a fund is non-diversified under the Investment Company Act or if it has, or intends to have, a policy of concentrating in an industry or group of industries.

Funds may need to devote special attention to achieving a balance between limitations of space and providing potential investors meaningful disclosure about a fund's investments, policies, and risks. The Commission requests comment on whether the rule should require some form of standardized presentation of the degree and kind of risk presented by a fund relative to other mutual funds. One approach might be to describe where the fund fits on a risk continuum from low risk (e.g., a money market fund), to moderate risk (e.g., a growth and income fund investing in S&P 500 stocks and high quality bonds), to high risk (e.g., an emerging market country fund). The Commission also requests comment on the advantages and disadvantages of alternative disclosure formats such as narrative discussion, a numerical scale from 1 (least risky) to 10 (most risky), or other visual or symbolic representations.

Paragraph (g)(2)(vi) calls for disclosure about any options shareholders have regarding the receipt of dividends and distributions.³⁷ To the extent feasible, a fund might put this disclosure in the order form next to boxes where a prospective investor could mark any option selected. This paragraph also requires disclosure concerning tax consequences of investing in a fund, but such disclosure is required only to the extent that tax consequences are material to investing in the fund; for example, tax-exempt or municipal funds, or

³⁷This disclosure corresponds to Item 6(f) of Form N-1A.

government securities funds with tax advantages under state law should discuss tax consequences. The disclosure specifically required by Items 6(g)(i) through (iii) of Form N-1A is not required in an off-the-page prospectus for funds without such tax consequences. Thus, for example, an off-the-page prospectus need not state that a fund will distribute all of its net income and gains to shareholders and that such distributions are taxable income or capital gains.

Paragraphs (g)(2)(vii) and (viii) call for disclosure about purchases and redemptions of shares. In section 10(a) prospectuses, these topics can occupy substantial space, especially if a fund offers a variety of special features. In many respects, such disclosure in section 10(a) prospectuses often serves as a reference manual for existing shareholders and would continue to serve that important function for investors who purchase through off-the-page prospectuses; investors would receive the section 10(a) prospectus with the confirmation of their purchase.

Accordingly, the Commission does not propose that an off-the-page prospectus disclose all possible mechanisms for purchasing or redeeming shares. Instead, it is sufficient to disclose how investors may purchase shares using the order form and to explain how to obtain further information at no cost -- for example, through a toll-free telephone number. Similarly, the information required by Item 7(c) of Form N-1A concerning variations in or elimination of sales loads would not be required. Instead, paragraph (g)(2)(vii)(B) would require only a statement that such arrangements are available, together with an explanation of how to obtain information at no cost about such arrangements.²⁸ Similarly, paragraph (g)(2)(viii) would require only a statement that a fund's shares are redeemable, an explanation of how to obtain information at no cost about redemption procedures, and

²⁸Such two-step procedures for load variations and for redemption procedures were suggested in the ICF Submission, *supra* note 33, at 10 and 13.

disclosure of any charges or restrictions³⁹ upon redemptions. Funds would be able to use follow-up mailings to enable investors to choose redemption options, such as check writing privileges, for which a signature or other information is required.

Paragraph (g)(2)(ix) would require disclosure about pending material legal proceedings. This requirement corresponds to Item 9 of Form N-1A and accordingly should require disclosure only under unusual circumstances.

With the exception of the provision for performance data in paragraph (g)(2)(iii), the wording of the disclosure provisions is based on that used in the requirements for the section 10(a) prospectus under Form N-1A. This is consistent with the off-the-page prospectus' function under section 10(b) of the Securities Act as a prospectus that omits or summarizes the information in the section 10(a) prospectus. The relationship to the Items of Form N-1A also should make it easier for funds to prepare off-the-page prospectuses, since they can refer to their section 10(a) prospectuses. Many funds may be able to base their core off-the-page disclosure on any summary or synopsis included in the section 10(a) prospectus; and their experience in construing the requirements of Form N-1A should be helpful in preparing disclosure for off-the-page prospectuses.

Except as specifically noted in paragraphs (a)(3) and (a)(5), the proposal would not affect the obligation of off-the-page prospectuses to comply with the provisions of the rest of rule 482. For example, under paragraph (a)(6), any advertisement containing performance data must include a legend discussing the limitations of performance data, and any performance data must be computed according to paragraphs (d) through (f); because they would include performance information, off-the-page prospectuses would be subject to those requirements. Under paragraph (a)(7), funds holding themselves out as money market funds must include a specified statement about certain risks of the fund.

³⁹Restrictions requiring off-the-page disclosure might include special procedures for certificated shares or requirements for signature guarantees. See Form N-1A, Guide 27 (Redemption or Repurchase)

Proposed paragraph (g) would add certain format requirements to those already provided in rule 482. Paragraph (g)(2)(iii) would require performance data to appear within a table or a box. Under paragraph (g)(2)(iv) and the General Instruction to paragraph (g)(2), the risk disclosure must be prominent and may not be separated from the disclosure of investment objectives and policies. Paragraph (g)(5) would require legends about sales charges to appear prominently, in a separate paragraph, and within a box. In addition, paragraph (g)(6) would require that the blank and text for indicating interest in investing and the blank and text for requesting the section 10(a) prospectus appear next to each other and be of the same format and type.

Apart from the general requirement of conciseness in paragraph (g)(2), the rule does not impose any express length limit on off-the-page prospectuses.⁴⁰ Similarly, proposed paragraph (g) does not mandate any sequence for the response to the indicated disclosure items. The note at the end of paragraph (g)(2) states that the information need not be set forth in the order specified and may be presented in a question and answer format. The proposed provisions would not limit the ability of off-the-page prospectuses to include disclosure other than that specifically required by paragraph (g)(2) as long as the substance of the information is included in the section 10(a) prospectus;⁴¹ under certain circumstances, additional disclosure might be necessary in order for the off-the-page prospectus as a whole not to be misleading. The Commission requests comment whether the rule should contain other format restrictions. For example, should the rule limit the use of footnotes, especially in disclosure concerning performance or fees and expenses? Should the rule contain

⁴⁰*Cf.* Advertising by Investment Companies, Securities Act Release No. 6116 (Aug. 31, 1979), 44 FR 52816, 52817 (in adopting rule 434d, the predecessor to rule 482, the Commission eliminated a proposed requirement that advertisements not exceed 600 words).

⁴¹*See* Securities Act section 10(h), 15 U.S.C. § 77j(h); rule 482. *See also supra* note 30.

additional requirements regarding type face or size?⁴² Should the rule contain special prominence requirements for direct mail pieces, which will tend to be longer, so that core information is not obfuscated? Should the rule limit what kinds of materials may be mailed together with an off-the-page prospectus?⁴³

The Securities Act provides significant protections against the use of a misleading off-the-page prospectus. The provisions of sections 12(2) and 17(a) of the Securities Act apply to rule 482 advertisements as omitting prospectuses used in the offer and sale of securities, and hence would apply to off-the-page prospectuses, as would the anti-fraud provisions of section 10(b) of the Exchange Act and rule 10b-5.⁴⁴ Moreover, while section 10(b) of the Securities Act⁴⁵ provides that an omitting or summary prospectus does not carry liability under section 11 of the Securities Act,⁴⁶ section 10(b) authorizes the Commission to

⁴²Rule 420 under the Securities Act already requires omitting prospectuses under rule 482 to be in at least 8-point type. 17 CFR 230.420.

⁴³Section 2(10)(a) of the Securities Act contains an exception from the definition of prospectus for certain selling material that is preceded or accompanied by a section 10(a) prospectus. Off-the-page prospectuses would be section 10(b) prospectuses, and thus, accompanying sales literature would not qualify for the exception.

⁴⁴See *supra* note 22. To prevail in a lawsuit under rule 10b-5, a plaintiff must prove that the defendant acted with scienter. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976). Although section 17(a) essentially prohibits negligent misstatements or omissions, unlike under section 12(2) most courts and commentators believe that an implied private right of action does not exist under section 17(a). See generally LOUIS LOSS, *FUNDAMENTALS OF SECURITIES REGULATION* 975-81 (2d ed. 1988).

⁴⁵Under section 10(h), an omitting or summary prospectus, even if filed as part of the fund's registration statement, is not deemed a part of the registration statement for the purpose of liability under section 11 of the Securities Act.

⁴⁶15 U.S.C. § 77k. Section 11 of the Securities Act imposes liability for material misstatements or omissions contained in a registration statement when it becomes effective. That section imposes strict liability on the issuer. Section 11 also imposes liability on a wide variety of other defendants, such as persons who signed the registration statement, directors of the issuer at the time the statement is filed, persons who consented to be named in the statement, experts who consented to be named in the statement, and underwriters.

There are certain differences between liability under section 11 and section 12. For example, section 11 does not impose liability on sellers of securities other than issuers. Moreover, under section 11 issuers do not have the "reasonable care" defense that they have under section 12(2). For an in-depth discussion and comparison of liability under sections 11 and 12(2), see Loss, *supra* note 44, at 887-906.

suspend the use of a defective summary or omitting prospectus. This administrative remedy supplements the Commission's stop order powers under section 8 of the Securities Act.¹⁵ The Commission requests comment whether these protections are adequate, or whether additional provisions should be added to the rule to control hype or extravagant claims in off-the-page prospectuses.

C. Relationship to Section 10(a) Prospectuses

The current prohibition against including an order form in a rule 482 advertisement was intended to address concerns about the relationship between the advertisement and the section 10(a) prospectus. This prohibition codified a no-action position that sought to prevent confusion between an advertisement and the section 10(a) prospectus.¹⁶ In proposing the amendment to rule 482 to prohibit order forms, the Commission expressed concern about consistency with the legend urging investors to read the section 10(a) prospectus before investing.¹⁷

In light of further consideration and experience under rule 482, those concerns do not appear to require the maintenance of a blanket prohibition upon the inclusion of an order form. Investor confusion between an off-the-page prospectus and the section 10(a) prospectus is unlikely to occur if, as proposed, an off-the-page prospectus is required to alert investors to the availability of more information in the section 10(a) prospectus. In place of the legend required by paragraph (a)(3) urging investors to read the section 10(a) prospectus before investing, paragraph (g)(3) would require off-the-page prospectuses to

¹⁵15 U.S.C. § 77h.

¹⁶Federated Investors, Inc. (pub. avail. June 30, 1985).

¹⁷Advertising by Investment Companies; Proposed Rules and Amendments to Rules, Forms, and Guidelines, Securities Act Release No. 6660 (Sept. 17, 1986), 51 FR 34384, 34391. Similarly, in adopting the summary prospectus rule, the Commission stated its intention to provide additional means for disseminating information, but not to supplant the section 10(a) prospectus as the primary selling document. Adoption of Summary Prospectus Rule 434A and Amendments to Forms S-1 and S-9, Securities Act Release No. 3722. [1952-1956 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,415 (Nov. 26, 1956) (adopting summary prospectus rule).

state that the section 10(a) prospectus contains more information about the fund, and that investors who are not familiar with mutual funds may wish to obtain the section 10(a) prospectus before investing.

Proposed rule 482(g) would preserve the role of the section 10(a) prospectus as a fund's primary disclosure document, even though it would eliminate the rule's current prohibition on purchasing fund shares directly from an omitting prospectus. Off-the-page prospectuses would supplement -- not supplant -- the use of section 10(a) prospectuses.³⁰ As required under the Securities Act, delivery of the section 10(a) prospectus would precede or accompany confirmation of a sale; and paragraph (g)(3) would require that the off-the-page prospectuses include a statement that the section 10(a) prospectus would be sent with the confirmation of purchase. Paragraph (g)(6) would require the order form to include a box that can be checked to request the section 10(a) prospectus; thus, the option of obtaining the section 10(a) prospectus would receive equal emphasis with the option of investing directly from the off-the-page prospectus. Section (g)(4) would require funds to send out section 10(a) prospectuses within two business days of any request, to ensure that investors receive additional information promptly. In addition, off-the-page prospectuses could include a telephone number that investors may call to request the section 10(a) prospectus. The Commission requests comment on whether a telephone number should be required.

D. Filing

Paragraph (c) of rule 482 provides that advertisements made pursuant to rule 482(a) need not be filed as part of a fund's registration statement; it notes, however, that rule 497³¹

³⁰PROTECTING INVESTORS report. *supra* note 1, at 365.

³¹17 CFR 230.497.

requires advertisements to be filed with the Commission unless filed with the NASD.³² This proposal would not amend paragraph (c).

Proposed paragraph (g)(8) would add a requirement that funds pre-file off-the-page prospectuses with the Commission or the NASD.³³ This requirement would apply for "a period ending one year after the first use of any advertisement . . . with respect to the securities that are the subject of the advertisement." The period of one year is intended to provide individual funds and regulators with a period to gain experience with the disclosure issues involved in that particular fund's use of off-the-page prospectuses. The period would apply separately to each security that is the subject of an off-the-page prospectus; thus, the period would run individually for each fund or series. Each security may present unique disclosure issues. Off-the-page prospectuses subject to paragraph (g)(8) would be required to be filed twenty days before they are submitted for publication to give adequate time for advance review. Off-the-page prospectuses submitted to the Commission for advance review would be transmitted with Form 482(g). The Commission anticipates that, like rule 482 advertisements at present, most off-the-page prospectuses would be filed with the NASD.

The Commission requests comment on this filing requirement and on other review arrangements that might achieve the same goals of reducing the likelihood of inadequate or misleading disclosure. For example, should prior review be limited to a period of one year, as proposed, or are off-the-page prospectuses sufficiently closer to section 10(a) prospectuses than to existing rule 482 advertisements that prior review should be required indefinitely? Should the rule provide a procedure by which the Commission or the NASD (or their staff,

³²Article III, section 35(c)(1) of the NASD's Rules of Fair Practice requires any advertisement used by a NASD member to be filed with the NASD.

³³The ICI has recommended that the NASD Rules of Fair Practice be amended to provide for pre-filing and clearance of off-the-page prospectuses on a temporary basis for a one year period after the adoption of the rule. ICI Submission, *supra* note 33, at 13-14. The proposals herein contemplate that the NASD will propose amendments to implement procedures for review of off-the-page prospectuses, but such amendments are not now before the Commission.

by delegated authority) could require a fund to resume pre-filing outside the one year period if a fund's disclosure were found deficient? Is the proposed period of twenty days sufficient, or do the proposed disclosure requirements of paragraph (g)(2) justify a longer or shorter period?

Proposed paragraph (g)(9) would require that three copies of an off-the-page prospectus be filed with the Commission within three days after the first use of an off-the-page prospectus unless copies already have been filed with the Commission. These filings would not be subject to advance review or clearance and would not be part of a fund's registration statement, but would be reviewed by the staff on an ad hoc basis for purposes of monitoring compliance with the rule. The definitive copies would be transmitted with Form 482(g). The filing requirement would apply to any use of an off-the-page prospectus, even after the one-year advance review requirement no longer applies.

E. Eligible Media

Paragraph (g)(7) would prohibit the transmission of off-the-page prospectuses to investors by radio, television, or other broadcast or electronic media. The rule would exclude radio, television, and other broadcast media because such media do not give viewers or listeners a sufficient period for continuous examination of all of the disclosure required under paragraph (g)(2).⁴⁴ Some electronic media, such as computer bulletin boards, may provide the capacity to read the disclosure for a sufficient period of time and to reproduce the disclosure and order form in print. The Commission, however, has received only limited indications of interest in advertising fund shares through such media or of the special concerns that might arise regarding such media. The Commission requests comment on whether rule 482(g) should permit the use of electronic media, and if so, which media might

⁴⁴The United Kingdom rules contain a comparable requirement. See *Conduct of Business Rules*, *supra* note 19, rule 7.23(4). In addition, broadcast advertisements cannot include an application form.

be used, what format off-the-page prospectuses in such media might take, and how such off-the-page prospectuses might be transmitted to potential investors.

The rule would not otherwise limit the media in which off-the-page prospectuses might be disseminated. Thus, funds could advertise by direct mail, as well as in magazines, newspapers and other print media. Rule 482 now permits advertisements made under paragraph (a) to be sent through direct mail; that would not change under proposed paragraph (g).³³ Direct mail has become a major component of many fund groups' marketing programs and may be particularly useful to smaller fund complexes that cannot easily afford the expense of mass advertising.³⁴ Direct mail may complicate monitoring and enforcement because direct mail pieces are less public than magazine and newspaper advertisements. Nevertheless, the filing and review requirements under paragraph (c) and paragraphs (g)(8) and (g)(9) should give the Commission sufficient capacity to monitor and enforce compliance with the rule. The Commission requests comment, however, whether it should prohibit the use of off-the-page prospectuses in direct mail. Limiting their use to mass media advertising might deter misleading disclosure, and often an advertiser's competitors can play an important role by drawing possibly deficient advertisements to the attention of regulators.

³³As originally adopted, rule 434d initially limited omitting prospectuses under the rule to use in bona fide publications. Rule 482 was amended in 1988 to delete that limitation in order to allow use in direct mail. Advertising by Investment Companies, Securities Act Release No. 6454 (Feb. 28, 1983), 48 FR 10297. Rule 494, by contrast, limits "newspaper prospectuses" for foreign government securities to advertisements appearing in newspapers, magazines and other periodicals that are distributed by second class mail. 17 CFR 230.494.

³⁴ICI Submission, *supra* note 33, at 5. Typically, an initial direct mailing contains a rule 482 advertisement, and section 10(a) prospectuses are sent only to those recipients who specifically request them. The ICI cites an estimate that the conversion rate for direct mailings (the percentage of recipients who actually invest) is 0.5%. *Id.* at 4 n.10. For that reason, fund representatives have informed Commission staff that generally it is too expensive to send section 10(a) prospectuses in direct mailings.

F. Cancellation

The *Protecting Investors* report recommended considering whether investors who purchase off-the-page should have an opportunity to cancel their purchases for a specified waiting period allowing for review of the section 10(a) prospectus.³⁷ The report suggested that such cancellation might involve either of two options: first, an escrow arrangement, under which an investor's money would be held in a bank account or money market fund until the end of the waiting period, when it would be invested in the fund the investor sought to purchase; or second, the investor's money would be invested in the fund at once, but if the investor requested redemption by the end of the waiting period, any front-end load would be refunded, and any contingent deferred sales load would be waived.

After further review, the Commission is not proposing to require or permit escrow arrangements, which do not appear consistent with the off-the-page rule's policy of reducing delays in the process of investing in direct marketed funds.³⁸ The Commission requests comment, however, on whether there is a justification for permitting the use of escrows, and, if so, what changes should be made to rule 22c-1 or other provisions of the securities laws.

Under the second option, an investor would bear the risk of fluctuations in net asset value during the waiting period, but if the investor opted to cancel the purchase, any front-

³⁷PROTECTING INVESTORS, *supra* note 1, at 368.

³⁸With an escrow, the investor's money would be invested at the end of the waiting period if the investor did not cancel the purchase. That delay in investment would not comply with rule 22c-1, which requires issuers of redeemable securities to price sales of such securities at the next net asset value computed after the receipt of an order to purchase. 17 CFR 270.22c-1. The Division of Investment Management has taken a no-action position under rule 22c-1 with respect to certain arrangements under which a purchase or redemption order would not be executed at the next determined net asset value following receipt of the order but would be determined at the next determined net asset value following a specified contingent event that made compliance highly impractical, if not impossible. See, e.g., Capital Preservation Fund (pub. avail. Sept. 11, 1990); Templeton Global Fund (pub. avail. Sept. 7, 1983). But see Dreyfus Index Fund (pub. avail. Sept. 21, 1987) (denying no-action relief for proposal that purchase orders received between noon and 4:00 p.m. be invested at next day's price rather than same day's price at close of New York Stock Exchange). Such no-action relief would not be appropriate for the escrow option.

end load would be refunded, or any contingent deferred sales load would be waived. The Commission is not proposing to *require* that funds offer such refunds or waivers to investors who purchase through off-the-page prospectuses. Such refunds or waivers, however, would be variations in or elimination of a fund's sales charges and would be permissible if they comply with the requirements of rule 22d-1.³⁹

G. Deletion of Form N-1A Summary Prospectus Instructions

Currently Form N-1A contains instructions for summary prospectuses pursuant to rule 431.⁴⁰ The Commission adopted the summary prospectus provisions for investment companies in 1972.⁴¹ In the intervening twenty years, however, to the best of the Commission's knowledge, no fund has published a summary prospectus. Proposed rule 482(g) should provide mutual funds a basis for publishing a condensed prospectus. Accordingly, the Commission is proposing to delete the summary prospectus instructions in Form N-1A. The Commission previously deleted the summary prospectus instructions in Form N-2, the closed-end fund registration form.⁴²

³⁹17 CFR 270.22d-1. Because the language of rule 22d-1 "contemplates sales loads paid at the time of purchase, the exemption provided by rule 22d-1 does not extend to scheduled variations in deferred sales loads." Exemptions for Certain Registered Open-End Management Investment Companies to Impose Deferred Sales Loads, Investment Company Act Release No. 16619 (Nov. 2, 1988), 53 FR 45275, 45279. Accordingly, exemptive orders permitting contingent deferred sales loads with scheduled variations have required that such scheduled variations comply with the conditions of rule 22d-1. Proposed rule 6c-10 contains the same requirement. *Id.*

⁴⁰17 CFR 230.431.

⁴¹Adoption of Rule Changes Relating to Investment Company Advertising, Amendments to Rules 134 and 434A of the Securities Act of 1933, New Rule 135A under the Act, the Amendment to Form S-5 to Provide for a Summary Prospectus, Securities Act Release No. 5248 (May 9, 1972), 37 FR 10071.

⁴²Registration Statement for Closed-End Management Investment Companies, Securities Act Release No. 6842 (Aug. 11, 1989), 54 FR 32993 (proposing release); Securities Act Release No. 6967 (Dec. 1, 1992), 57 FR 56826 (adopting release).

III. COST/BENEFIT OF PROPOSED ACTION

Proposed rule 482(g) would not impose any additional required costs on investment companies. Open-end companies that elect to rely upon the rule may incur some additional costs because off-the-page prospectuses in all likelihood would require more space than existing advertisements under rule 482 or under rule 134. To the extent, however, that a significant number of investors decide to invest from an off-the-page prospectus without requesting a section 10(a) prospectus, a fund's total marketing costs may be reduced.

The Commission requests comment upon the above assessment of costs and benefits associated with the proposed rule changes. Commenters should submit estimates for any costs and benefits perceived, together with any supporting empirical data.

IV. SUMMARY OF INITIAL REGULATORY FLEXIBILITY ANALYSIS

The Commission has prepared an Initial Regulatory Flexibility Analysis in accordance with 5 U.S.C. 603 regarding proposed rule 482(g). The Analysis explains that the proposal would provide potential investors with the option to purchase mutual fund shares directly from off-the-page prospectuses containing specified prospectus disclosure. Off-the-page prospectuses would be omitting prospectuses under section 10(b) of the Securities Act. The Analysis explains that the proposal is intended to give investors in direct marketed funds the option of investing more directly and quickly than at present, and with lower cost to funds and hence to shareholders. The Analysis states that the Commission considered significant alternatives to the proposal. Those alternatives included simplifying the level of disclosure that small entities would provide in an off-the-page prospectus or exempting small entities from the pre-publication review requirement. The Commission concluded that such alternatives would create the risk that investors would not receive comparable disclosure and not make properly informed investment decisions, or increase the risk that a small entity's off-the-page prospectus might contain inaccurate or misleading disclosure. To obtain a copy

of the Initial Regulatory Flexibility Analysis, write to Robert G. Bagnall, at Mail Stop 10-6, Securities and Exchange Commission, 450 5th Street, N.W., Washington, D.C. 20549.

List of Subjects in 17 CFR Parts 230, 239 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 is proposing to amend Chapter II, Title 17 of the Code of Federal Regulations as follows:

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

The authority citation for Part 230 continues to read in part as follows:

AUTHORITY: 15 U.S.C. §§ 77b, 77c, 77d, 77e, 77f, 77g, 77s, 77sss, 78c, 78j, 78m, 78n, 78o, 78u, 78uu, 79a, 80a-8, 80a-29, 80a-30, and 80a-37, unless otherwise noted.

Section 230.432 is amended by revising paragraphs (a)(3) preceding the Note and (a)(5), and by adding paragraph (g) to read as follows:

§ 230.432 Advertising by an Investment Company as Satisfying Requirements of Section 13.

• • • • •

3. Except as provided in paragraph (g) of this section, it states conspicuously from whom a prospectus containing more complete information may be obtained and that an investor should read the prospectus carefully before investing.

• • • • •

5. Except as provided in paragraph (g) of this section, it does not contain and is not accompanied by any indication by which a prospective investor may invest in the investment company, provided, however, that a prospectus meeting the requirements of section 131 of the Act by which a unit investment trust offers periodic payment plan certificates may contain a similar indication through the prospectus includes another

prospectus that, pursuant to this rule, omits certain information required by section 10(a) of the Act regarding investment companies in which the unit investment trust invests.

• • • • •

(g) An advertisement made pursuant to paragraph (a) of this section may contain an application by which a prospective investor may invest in an investment company, or incorporate by reference an attached or enclosed application, if:

(1) The advertisement is with respect to an open-end management investment company that has an effective registration statement on Form N-1A and that:

(i) first publicly sold the shares being offered by the advertisement at least two years prior to publication of the advertisement,

(ii) intends to comply with the requirements of Subchapter M, Sections 851-860, of the Internal Revenue Code during the current taxable year,

(iii) is not exempt from section 22(e) of the Investment Company Act [15 U.S.C. § 80a-22(e)],

(iv) is not a management separate account offering variable insurance products, and

(v) has outstanding only one class of shares and does not invest its assets entirely in the shares of another open-end management investment company.

(2) The advertisement contains the following information more concisely (to the extent feasible) than in the company's section 10(a) prospectus:

(i)(A) the company's name; and

(B) identification of the type of fund (*e.g.*, money market fund, bond fund, balanced fund, etc.), or a brief statement of the company's investment objectives;

(ii) the fee table called for by Item 2(a)(i) of Form N-1A, including the example, together with any narrative necessary to make the table understandable and not misleading;

(iii) the following information, set out prominently in a table or in one or more boxes or similar border enclosing such data on all four sides:

(A) in the case of a "money market fund," a quotation of current yield and, at the option of the company, effective yield, as permitted by paragraph (d) and (f) of this section;

(B) in the case of any other type of open-end investment company, quotations of total return as provided for in paragraph (e)(3) of this section and, at the option of the company, quotations of yield permitted by paragraphs (e)(1), (e)(2), and (f) of this section; and

(C) the company's portfolio turnover rate pursuant to Item 3(a) of Form N-1A;

(iv)(A) a statement that the company is a mutual fund, and if the company is non-diversified under the Investment Company Act, a statement to that effect;

(B) a concise description of the company's investment objectives and policies, including: a short description of the types of securities in which the company invests or will invest principally, and, if applicable, any special investment practices or techniques that will be employed in connection with investing in such securities; and, if the company has or proposes to have a policy of concentrating in a particular industry or group of industries, identification of such industry or industries; and

(C) a brief discussion of the principal risk factors associated with investment in the company, set forth prominently;

(v) the name of the company's investment adviser;

(vi)(A) any options shareholders may have as to the receipt of such dividends and distributions; and

(B) the tax consequences of investment in the company to the extent that any tax advantages of portfolio securities and of investing in the company are material to investment in the company;

(vii)(A) the procedure by which the company's shares may be purchased using the application, and an explanation of how to obtain information at no cost about additional purchase procedures;

(B) if applicable, a statement that scheduled variations in or elimination of the sales load are available (e.g., large purchases, letters of intent, accumulation plans, dividend reinvestment plans, withdrawal plans, exchange privileges, employee benefit plans, redemption reinvestment plans), and an explanation of how to obtain information at no cost about such variations in or elimination of the sales load;

(C) any minimum initial or subsequent investment;

(D) if applicable, a general statement of the purpose of fees pursuant to § 270.12b-1 of this chapter;

(viii)(A) a statement that the company's shares are redeemable, and an explanation of how to obtain information at no cost about redemption procedures;

(B) a description of any restrictions on redemption and any charges that may be attendant upon redemption;

(C) a statement of any minimum account balance; and

(D) if applicable, a brief description if the company may refuse to honor a request for redemption for a certain time after a shareholder's investment; and

(ix) any material pending legal proceedings.

GENERAL INSTRUCTION -- The information provided need not be set forth in the order above, may be presented in a question and answer format, and may be presented in the application. The information provided pursuant to paragraphs (g)(2)(iv)(B) and (C) of this section, however, may not be separated by any other disclosure.

(3) In place of the statement required by paragraph (a)(3) of this section, the advertisement contains:

(i) a statement that the advertisement contains key information about the company;
and

(ii) a statement that the company's section 10(a) prospectus contains more information about the company and is available free upon request, that investors who are not familiar with open-end companies may wish to obtain the section 10(a) prospectus before investing, and that the section 10(a) prospectus will be sent to investors with the confirmation of an investment (this statement should include instructions about how to obtain the section 10(a) prospectus by any means -- such as a toll-free telephone line -- other than the blank on the application form discussed in paragraph (g)(6) of this section).

(4) When a request for a section 10(a) prospectus is received by the company, the section 10(a) prospectus is sent within two business days of receipt of the request by first class mail or other means designed to ensure equally prompt delivery;

(5) The advertisement contains one or more of the following legends, as applicable, set forth prominently in a separate paragraph and set off by a box or similar border enclosing the legend(s) on all four sides:

(i) If the company imposes a front-end sales load:

"If you invest in this fund, you will pay a sales commission of [the maximum load, expressed as a percentage of the amount invested] that will not be refunded if you withdraw your investment."

(ii) If the company imposes a contingent deferred sales load:

"If you invest in this fund and you withdraw your investment within [the maximum number of years during which any contingent deferred sales load is imposed], you will be charged a sales commission of up to [the maximum deferred sales load, expressed as a percentage] when you withdraw, depending on how long you stay in the fund. The longer you stay in the fund, the lower that commission will be."

NOTE -- To the extent that a company waives or refunds loads for investors who redeem their investment within a specified period after purchase, the above

legends shall be modified to disclose the terms of such refund or waiver, the possibility of fluctuations in net asset value during the specified period, and any tax consequences of redemption within the specified period.

(6) The application contains a blank that investors can mark to request the company's section 10(a) prospectus, together with text stating that the investor does not wish to invest at present but would like to obtain the section 10(a) prospectus. That blank and text must be adjacent to, and in the same format and type as, the blank and text for indicating interest in investing.

(7) The advertisement is not transmitted to investors by radio, television, or other broadcast or electronic media.

(8) During a period ending one year after the first use of any advertisement pursuant to this paragraph (g) with respect to the securities that are the subject of the advertisement, five copies of the advertisement are filed with the Commission in accordance with § 230.497 of this chapter no later than twenty days before the advertisement is submitted for publication. A national securities association registered under section 15A of the Securities Exchange Act of 1934 [15 U.S.C. § 78o] that has adopted rules providing standards for the investment company advertising practices of its members and has established and implemented procedures to review that advertising may adopt and implement other requirements regarding the timing and procedures for filings made pursuant to this paragraph (g).

NOTE -- Under Rule 497 [17 CFR 230.497] advertisements filed with the NASD are deemed filed with the Commission.

(9) In addition to any filing pursuant to § 230.497 of this chapter or section 24(b) of the Investment Company Act [15 U.S.C. § 80a-24(b)] and the rules thereunder, including any filing pursuant to paragraph (g)(8) of this section, three copies of the advertisement in definitive form are filed with the Commission within three days after the first use of the

advertisement unless copies of the advertisement actually have been filed with the Commission already pursuant to paragraph (g)(8) of this section.

PART 239 - FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

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

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

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

4. The authority citation for Part 274 continues to read in part as follows:

AUTHORITY: 15 U.S.C. 80a-1 *et seq.*, unless otherwise noted.

NOTE: Form N-1A is not codified in the Code of Federal Regulations.

5. By amending Form N-1A (§§ 239.15A and 274.11A) by removing the Instructions as to Summary Prospectuses.

6. By adding § 239.482 and Form 482(g) to read as follows:

§ 239.482. Form 482(g), Filing of off-the-page prospectus for pre-publication review, and Notice of use or publication of off-the-page prospectus.

This form shall be filed with respect to copies of off-the-page prospectuses submitted to the Commission as required under rule 482(g) (§ 230.482(g) of this chapter).

See Appendix A for text of Form 482(g).

Note: The text of Form 482(g) will not appear in the Code of Federal Regulations.

By the Commission

Jonathan G. Katz
Secretary

March 19, 1993

U.S. Securities and Exchange Commission
Washington, D.C. 20549

FORM 482(G)

Mark one

**FILING OF OFF-THE-PAGE PROSPECTUS FOR PRE-PUBLICATION
REVIEW**

OR

NOTICE OF USE OR PUBLICATION OF OFF-THE-PAGE PROSPECTUS

Pursuant to Securities Act Rule 482(g) [17 CFR 230.482(g)]

1. Investment Company Act File Number

811-

2. Exact name of investment company as specified in registration statement:

3. Address of principal executive office: (number, street, city, state, zip code)

4. Date of Use or Publication of Off-the-Page Prospectus

INSTRUCTIONS

1. This form must be attached to (A) a copy of a draft off-the-page prospectus that is submitted to the Commission for pre-publication review, or (B) a definitive copy of an off-the-page prospectus that is submitted after its first publication, in either case pursuant to rule 482(g).

2. Open-end companies whose principal underwriters are members of the National Association of Securities Dealers, Inc. (NASD) should file draft off-the-page prospectuses with the NASD for pre-publication review.

3. Five copies of submissions for pre-publication review must be filed at least twenty days before the draft off-the-page prospectus is to be submitted for publication.

4. Three copies of submissions for definitive copies shall be filed within three days after the first use or publication of an off-the-page prospectus.

5. Item 4 should be completed only for filings of definitive copies.