

**MEMO# 25357**

July 27, 2011

# **GAO Issues Report on Mutual Fund Advertising**

[25357]

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TO: ADVERTISING COMPLIANCE ADVISORY COMMITTEE No. 7-11

CLOSED-END INVESTMENT COMPANY MEMBERS No. 59-11

ETF ADVISORY COMMITTEE No. 51-11

SEC RULES MEMBERS No. 92-11 RE: GAO ISSUES REPORT ON MUTUAL FUND ADVERTISING

Section 918 of the Dodd-Frank Wall Street Reform and Consumer Protection Act required the U.S. Government Accountability Office (“GAO”) to conduct a review of mutual fund advertising, focusing on the advertising of past performance information. The GAO recently issued its report, which is summarized briefly below. [\[1\]](#)

The report examined: (i) what is known about the impact of fund advertisements on investors; (ii) the extent to which performance information is included in advertisements; and (iii) the regulatory requirements for fund advertisements and how they are administered and enforced. To address these objectives, GAO reviewed existing and proposed Securities and Exchange Commission (“SEC”) rules and Financial Industry Regulatory Authority (“FINRA”) rules, conducted a literature review of studies related to mutual fund advertising’s impact on investors, and reviewed a random sample of 300 fund advertisements. GAO also met with regulators, fund companies, academics, and investor protection and industry groups, including the Institute.

GAO found that while some academic studies and others have suggested that advertisements that emphasize a fund’s past performance can influence investors to make inappropriate investments, the evidence that investors are harmed by these advertisements is mixed. For example, industry surveys show that investors are increasingly relying on information from financial advisors and other sources and use a variety of information – beyond performance information – when making investment decisions. Another factor that helps limit the potential for investors to be misled by fund advertising is regulatory review of fund advertisements.

GAO also found that FINRA does not always effectively communicate changes in advertising rule interpretations that arise when the regulatory staff identifies concerns about new

material being advertised by fund companies. GAO also reported that some firms stated that FINRA analysts have deemed portions of material non-compliant when that same material had been previously reviewed and deemed compliant.

Based on these findings, GAO recommended that the SEC take steps to ensure that FINRA develops sufficient mechanisms to notify all fund companies about changes in rule interpretations for fund advertising. Both SEC and FINRA agreed with the recommendation. In response to the recommendation, FINRA stated that it had already taken the following steps to address the GAO's points:

- FINRA intends to publish, through a Notice to firms or by other means, any significant new interpretation of the advertising rules that affects a broad section of the industry;
- FINRA will develop one or more mechanisms to provide a regular summary of advertising issues and its interpretation of the application of the advertising rules to these issues; and

FINRA's Advertising Regulation Managers, as part of their regularly held meetings, will pay particular attention to the question of whether any novel interpretive issues raised in filed advertisements affect a broad section of the industry and, if so, whether FINRA should issue a Notice or other guidance to the industry.

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#### **endnotes**

[1] See United States Government Accountability Office Report to Congressional Committees: Mutual Fund Advertising: Improving How Regulators Communicate New Rule Interpretations to Industry would Further Protect Investors (July 2011), available at <http://gao.gov/mobile/products/GAO-11-697>.