The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

COMMENT LETTER

July 31, 2002

Comment Letter on SEC Fund Advertising Proposal, August 2002

July 31, 2002

Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, D.C. 20549-0609

Re: Proposed Amendments to Investment Company Advertising Rules (File No. S7-17-02)

Dear Mr. Katz:

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The Investment Company Institute[1] appreciates the opportunity to comment on the revisions proposed by the Securities and Exchange Commission to the investment company advertising rules.[2] The Commission has proposed to amend Rule 482 under the Securities Act of 1933 to: (1) eliminate the "substance of which" requirement, thereby permitting investment companies to include in an advertisement information that is not included in the statutory prospectus; (2) enhance the disclosure in fund performance advertisements by imposing additional specific disclosure requirements; and (3) require that an advertisement that includes performance information include a toll-free phone number where investors can obtain total return quotations current to the most recent month end.

In addition, the Commission has proposed to amend Rule 156 under the Securities Act to provide further guidance regarding the factors to be weighed in considering whether a statement involving a material fact in investment company sales literature is, or might be, misleading. Finally, the Commission has proposed amendments to Rule 134 under the

Securities Act, the “tombstone ad” rule, to exclude registered investment companies from relying on it.

The Institute supports most of the Commission’s proposals. We are particularly pleased that the proposed revisions to Rule 482, in large part, track recommendations that the Institute submitted to the Commission in July 2001.3 We have a number of comments on the proposals, which are intended to help ensure that the amendments will be effective in achieving their intended goals and will not impose undue burdens on investment companies. In summary, our comments are as follows:

- We strongly support the current regulatory framework governing advertising practices by investment companies, which has served investors well.
- We strongly support the elimination of the “substance of which” requirement from Rule 482, which was mandated by Congress in the National Securities Markets Improvement Act of 1996 and which should benefit investors by resulting in improved fund communications.
- We strongly support the Commission’s decision not to amend Rule 482 to provide that fund performance advertisements would be considered to comply with the rule’s timeliness requirement only if they include performance information current to the most recent month end prior to submission for publication. We agree that changing the quarter-end standard in the current rule to month-end would impose substantial costs and would not result in any meaningful benefits to investors beyond those that would be achieved by making month-end performance information available to investors, as under the Commission’s proposal.
- We strongly oppose the proposal that performance information would have to be made available within three calendar days of the most recent month end, because it fails to recognize that the time needed to make fund performance information available to investors will differ among funds. As a result, in many instances, funds will not be able to meet the proposed three-day period. Instead, the rule’s timeliness requirement should be deemed satisfied if month-end performance information is made available as soon as reasonably practicable, based on the particular facts and circumstances.
- We seek clarification that, in the case of variable insurance products, the source of month-end performance information should be the insurance company sponsor, rather than the underlying fund.
- We reiterate our previous recommendation that funds should have flexibility regarding the method (e.g., website or toll-free phone number) by which investors can obtain performance information current to the most recent month end, rather than being required to make the information available through a toll-free phone number.
- We continue to recommend that fund advertisements not be required to refer investors to another source for more current performance information if the performance information in an advertisement is current to the most recent month end prior to its use, because such a requirement is unnecessary and could cause investor confusion.
- With respect to the narrative disclosure that would be prescribed by Rule 482, we: (1) recommend that the Commission clarify that funds may tailor the disclosure so long as it communicates the concepts required to be disclosed; (2) support requiring the disclosure to be presented in close proximity to the performance data in an advertisement and not in footnotes, but oppose the proposed type size and style requirements because they are unnecessary; and (3) request clarifications related to the application of the narrative disclosure presentation requirements to radio or

television advertisements and fund websites.
- We oppose the proposal to prohibit funds from creating “tombstone” advertisements in reliance on Rule 134. The limitations on the contents of such ads make a heightened liability standard unnecessary and, in the absence of any apparent abuses, the increased latitude accorded to Rule 482 advertisements does not provide a sufficient reason to eliminate this option.

We strongly urge the Commission to confirm that performance information that is computed in accordance with Rule 482’s requirements and current as required by the rule will not be deemed fraudulent or misleading.

Each of these comments is discussed in greater detail below.

I. The Current Regulatory Framework

In addition to seeking comment on the various specific revisions proposed by the Commission to the advertising rules, the Proposing Release seeks comment generally on the current regulatory framework that governs advertising practices by investment companies. The Institute strongly supports the current regulatory framework. We believe that the standards imposed by the Commission have served investors well.4 By ensuring that all funds that advertise performance are subject to the same computation and currentness standards, and the same disclosure requirements, the Commission’s advertising rules have guarded against abuses that could result in the absence of such regulation, such as cherry picking. As such, the rules have helped to ensure that investors can rely on the veracity and fairness of the performance information provided in mutual fund sales material and have enabled investors to compare fairly uniform performance information among funds.

In considering the appropriateness of the current regulatory framework, as well as the specific rule changes proposed by the Commission, it is important to keep in perspective the purpose of fund ads—i.e., they are used to bring to the attention of potential investors the availability of various funds, and to provide investors basic information, which may include performance information, about funds. Fund advertisements are not intended to be the exclusive source for investors of information about the fund, which is why all advertisements under Rule 482 or 134 are required to encourage potential investors to read the fund’s prospectus carefully before investing and include information about how an investor may obtain the prospectus. Indeed, an investor may not buy fund shares off of an advertisement. With this in mind, we believe it appropriate that, in lieu of imposing lengthy and detailed disclosure requirements on fund ads, Rule 482 establish the basic parameters for such ads (e.g., uniform standards for performance data) while still preserving to the funds sufficient flexibility to design ads that they believe best communicate with investors. Many of the Institute’s recommendations below are intended to ensure that, as revised, Rule 482 does, in fact, provide funds this necessary flexibility.

II. Proposed Revisions to Rule 482

The Institute generally supports the proposed amendments to Rule 482. In particular, we strongly support the Commission’s proposal to eliminate the “substance of which” requirement from Rule 482 pursuant to Section 24(g) of the Investment Company Act. As a result, funds will be able to include more relevant and timely information in their advertisements and eliminate from their statutory prospectuses information that clutters

the prospectus and can obscure more important information. These changes should benefit investors by resulting in improved fund communications.

We also support most of the other proposed changes to Rule 482, which are largely consistent with recommendations we made to the Division last year. Our specific comments on some of these changes are set forth below.

A. The Currentness of Performance Information

1. The Appropriateness of Not Requiring Month-end Information in Advertisements and Sales Literature

As proposed to be revised, Rule 482 would continue to require that all performance data contained in an advertisement be current "as of the most recent practicable date considering the type of investment company and the media through which the data will be conveyed." As with the current rule, an advertisement containing total return quotations would be considered to satisfy this "most recent practicable date" requirement if such quotations are current to the most recent calendar quarter ended prior to submission of the advertisement for publication provided, however, that it also complied with a new, second condition. Under this new condition, performance information current to the most recent month end would have to be made available via a toll-free phone number.

The Proposing Release states that the Commission considered and determined not to require that all advertisements include month-end performance information. We strongly support that decision. The inappropriateness of such a requirement—and its resulting substantial costs—were discussed in detail in our 2001 letter as well as in the Proposing Release.5 For example, as noted in our letter, the sales materials that are provided by mutual fund distributors to financial intermediaries, such as broker-dealers and retirement plan sponsors, for distribution to investors contain performance information that currently is updated on a quarterly basis. If month-end numbers were required under Rule 482, all such sales literature would have a "shelf life" of only one month, and distributors would be forced to update the material twelve times a year rather than the current four, thereby substantially increasing costs.6

Indeed, one fund group that produces a brochure containing the calendar quarter-end average annual total returns of its funds (which include over 100 fund classes) estimates that its out-of-pocket costs for typesetting, printing and related charges (currently approximately $7,310 per update for 50,000 copies) would increase by approximately $58,480 per year (over 800 percent) for this one item. Another fund group estimates that its print production costs for certain materials that it sends to intermediaries who distribute its funds would increase significantly—from $450,124 to $776,100 for quarterly fund fact sheets and from $500,000 to $1,500,000 for quarterly booklets containing fund performance and other information. It should be noted that none of the foregoing estimates include other costs that likely also would increase, such as mailing costs, NASD filing fees, computer programming, and personnel costs. While not included in the foregoing estimates, these additional costs should not be disregarded. For example, a third fund group has indicated to us that requiring monthly updating of its sales materials would triple its annual costs from approximately $500,000 to approximately $1,500,000, in part because of a need to hire eight additional people to perform associated tasks.

2. The Currentness of Information Provided Through the Toll-free Phone Number

Under the Commission's proposal, the month-end performance information that would be made available via a toll-free telephone number would have to be current to the most recent month ended three calendar days prior to the date of use of the ad. The Commission has sought comment as to whether the proposed three calendar day period is an appropriate period of time.

The Institute strongly opposes the proposed three-day requirement. 7 Instead, we recommend that funds be permitted to provide updated month-end performance numbers as soon as reasonably practicable after the month end rather than within a prescribed time period. This approach is necessary in light of the fact that the process of computing, testing, and distributing performance information will differ among funds based upon their particular facts and circumstances. While some entities may be able comply with the rule's proposed three-calendar-day period, it is our understanding that many would be unable to have updated performance information available in less than ten business days after month end, notwithstanding their best efforts.

For example, it is not uncommon for fund supermarkets to obtain the performance information on the funds they offer from third-party services, such as Morningstar or Lipper. In order for these services to provide performance information to a supermarket, they must first obtain the raw data from the fund and conduct the necessary calculations to determine performance. We understand that, under the best of circumstances, it takes anywhere from at least three business days to ten business days from the time these services obtain the raw data from the funds to compute the performance for a fund and provide it to the fund supermarket. Upon receiving the information, the fund supermarket must take the steps necessary to update its website or its automated phone systems to reflect the updated performance numbers. In instances such as these, or other situations in which fund performance is calculated and/or disseminated by third parties (such as where the fund employs a third party administrator or in the context of retirement plans where the plan's recordkeeper or administrator also offers funds advised by other firms), providing the performance numbers within three days simply would not be feasible.

In light of the many variables that can affect how long it will take to make month-end performance information available, a rigid, one-size-fits-all requirement is inappropriate. If, however, the Commission determines to include a specific time period in Rule 482(g), the adopting release should clarify that, inasmuch as the provisions of Rule 482(g)(1) and (2) are not mandatory but, instead, provide a safe harbor to funds, a fund's failure to comply with these provisions does not necessarily mean the fund has violated the rule's requirement to provide timely performance data. As such, a fund's inability to have its month-end performance data available by phone within the number of days specified in the rule8 does not mean that the fund has failed to comply with Rule 482(g), so long as the performance information provided by phone is current as soon as practicable after the prior month end based upon the fund's particular facts and circumstances.

3. Variable Insurance Products

Mutual funds underlying variable insurance products may prepare sales material that includes underlying fund performance information. This information cannot be provided to investors unless it is accompanied by performance information net of the contract charges imposed by the insurance company sponsor. Performance net of contract charges is calculated and supplied by the insurance company sponsor and not by the underlying

funds, which typically do not have the contract charge information in those instances where the underlying fund is not advised by the insurance company. Thus, in the case of sales material containing performance information for variable insurance products, the insurance company sponsor should be the source of the month-end performance information. Therefore, we seek clarification that a variable insurance product performance advertisement will satisfy the proposed currentness requirement if it provides the toll-free telephone number of the insurance company sponsor, rather than that of the underlying fund, even when the performance net of contract charges is accompanied by performance information of the underlying fund.

B. The Choice of Media Used to Provide More Current Performance Information

1. Flexibility in Choice of Media

The Commission has proposed that, to qualify for the safe harbor provided by Rule 482(g), funds must provide updated performance information via a toll-free (or collect) telephone number. In support of this provision, the Proposing Release notes that it would ensure the most widespread access to more current performance information.9

The Institute reiterates the recommendation in our 2001 letter that funds be provided greater flexibility to select the source they will use (e.g., a website or toll-free phone number) to provide investors more current performance information. We believe the Commission's requirement of a toll-free phone number as the medium by which funds must provide this information fails to fully appreciate the widespread and increasing access fund investors have to the Internet10 as well as the substantial costs of implementing the proposed requirement.

Permitting funds to disclose the updated performance information via a website is especially important for smaller fund complexes. Some of these complexes do not have automated voice response systems and, consequently, the proposal would be especially burdensome for them. Indeed, to satisfy this requirement, these smaller complexes may be faced with either ceasing to advertise fund performance information, incurring the expense of buying and maintaining an automated toll-free phone system, or dedicating one or more employees to providing the required disclosure through a toll-free phone number. Each of these choices would likely disadvantage smaller fund complexes.11

If the Commission does not revise the proposal as recommended above, the Institute recommends that Rule 482(g) at least provide an express accommodation so that funds that are sold exclusively through the Internet can provide their month-end information through the Internet. If the only means by which an investor may engage in transactions or communicate with a fund is through the Internet, it seems appropriate that those funds be permitted to provide updated performance information through their website. Accordingly, the Institute recommends that the Commission revise the proposed rule to expressly provide that, in these circumstances, a fund will be considered to have complied with the requirements of Rule 482(g) if it provides updated performance information via the fund's website.

2. Exception From Providing Month-End Performance by Phone

The Commission's proposal would require a fund to include a toll-free phone number in its advertisement even if the advertisement included performance current to the most recent

month end at the time of submission for publication. 12 In support of this, the Proposing Release notes that requiring the toll-free number in such instances would be useful to investors who, for example, refer to the advertisement at a later date. We urge the Commission to reconsider this requirement as we do not believe it is necessary to address the Commission's expressed concern. 13

The proposed amendments that would require the period during which the quoted performance occurred to appear adjacent to such data will alert an investor as to the timeliness of the performance data. This revision to the rule, which is consistent with the Institute's 2001 recommendations, should alleviate concerns that an investor might make an investment decision based upon stale performance information that the investor believed was, in fact, current.

The Institute also questions the usefulness to an investor of requiring that a fund provide updated performance information by phone when the information in the advertisement is current to the most recent month end prior to the date the advertisement was used. We note that the Commission's proposal is intended to ensure that funds that advertise performance information provide investors access to month-end information. As such, it should matter not whether this month-end information is provided in the ad itself or via a toll-free phone number. In fact, including a toll-free telephone number in ads containing month-end information may actually disserve investors by incorrectly leading them to believe that by calling the number, they will receive performance information that differs from that stated in the advertisement when, in fact, it will be the same information. For example, under the Commission's proposal, a fund that displays monthly performance information on its website but does not otherwise advertise its performance would be required to include on its website a toll-free phone number that a visitor to the website could call to receive the exact same performance information by phone. Requiring a fund to set up a telephone system for this purpose would impose needless costs on the fund, without providing any concomitant benefit to investors. 14 To avoid these results, we reiterate our recommendation that a fund that advertises performance current to the most recent month end not be required to provide that data via a toll-free phone number. 15

C. Narrative Disclosure in Rule 482 Ads

1. Text of the Required Disclosure

The Commission has proposed to add to the legend currently required by Rule 482 disclosure indicating that (1) past performance does not guarantee future results and (2) current performance may be lower or higher than the performance data quoted. 16 While the proposed rule language merely adds these new items to the list of information that must be disclosed in an ad's legend, the Proposing Release's discussion of these new items refers to them as "statements" that must be included in the advertisement. 17 The Institute recommends that the Commission clarify in the adopting release two issues relating to the proposed disclosure: first, that the legend does not necessarily have to contain separate statements or sentences regarding each point required to be addressed; and second, that funds have the flexibility to utilize in their legends any language that communicates the concepts required to be disclosed. This clarification, which would be consistent with the Commission's administration of the current legend requirement in Rule 482, would enable funds to design ads that they believe best communicate the required information clearly and concisely. 18

2. Presentation of Explanatory Information

To ensure that funds present certain information in their advertisements in a sufficiently prominent fashion, the Commission has proposed to require that the narrative disclosure comply with certain requirements relating to its placement. 19 The Institute supports the proposal to require that the disclosures that must be included in Rule 482 ads "be presented in close proximity to the performance data, and, in a print advertisement . . . be presented in the body of the advertisement and not in a footnote." 20 This proposal is generally consistent with recommendations we made in 2001, which were intended to ensure that the required disclosure is clearly visible to investors. 21

In addition to this placement requirement, the Commission has proposed to require funds to present the required narrative disclosures in a type size that is 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. We believe this requirement, which is taken from Rule 134, is inappropriate when applied to Rule 482 ads and unnecessary in view of the new placement requirements, which would govern most of the narrative information required by the rule to be included in ads, and the legibility requirements of Rule 420, which would continue to apply to Rule 482 ads under the Commission's proposal. 22 Indeed, the proposed placement requirements, when coupled with the requirements of Rule 420, will provide appropriate prominence to the disclosure required by Rule 482(b)(3) and will amply protect investors, thereby obviating the need for additional restrictions on the type size and style of this disclosure.

Importantly, in Rule 134, the requirements relating to type size and style only apply to a required legend that informs a person how to obtain a copy of a prospectus. By contrast, when added to Rule 482, these requirements would apply to far more extensive information. 23 Consequently, the language that would be required by this provision to be styled differently from the rest of the ad will likely comprise a substantial portion of the advertisement, making it more likely that it will be dismissed by readers as boilerplate and thereby defeat the Commission's intent to provide greater emphasis to this information. To avoid this, we recommend that the provisions of Rule 482(b)(5) be revised to delete the type size and style requirements.

3. Radio/Television Advertisement Disclosure

The Commission has solicited comment on whether the proposed presentation requirements are feasible for radio and television advertisements. The Institute requests that the Commission clarify in the adopting release the application of the narrative disclosure requirement to radio or television advertisements. In particular, we recommend that for purposes of spoken ads, such as those on radio or television, the Commission clarify that the "close proximity" requirement of Rule 482(b)(5) would not require that the disclosures immediately follow any performance information so long as they are given emphasis equal to that used in the major portion of the advertisement. Also, with respect to television advertisements, we recommend that the Commission clarify that such disclosures need not be provided orally and that, instead, they may be provided in written text on the television screen.

4. Website Disclosure

The Commission has sought comment on whether there are specific presentation requirements that should apply to the use of electronic media. The Institute believes that no specific presentation requirements are necessary with respect to electronic media. We

seek confirmation, however, that the “close proximity” requirement in proposed Rule 482(b)(5) would not require that the relevant disclosures be repeated on every page or screen of a website containing performance information. Instead, it should suffice if such disclosure is provided either: (1) on a screen that must be accessed prior to the investor accessing the actual performance information; or (2) through a pop-up message or link on the screen that contains the performance information.

III. Proposed Revisions to Rule 134

According to the Proposing Release, based upon the Commission’s proposed elimination of the “substance of which” requirement from Rule 482, the Commission believes that funds will no longer need to rely on Rule 134. The Commission therefore has proposed to exclude registered investment companies from relying on this rule, thereby eliminating their ability to utilize so-called “tombstone ads.” The Institute opposes this proposed change for the reasons discussed below.

While it may be true that, upon the adoption of the proposed revisions to Rule 482, a Rule 482 advertisement could include everything that a fund could put in a Rule 134 advertisement, this does not mean that funds should be denied the ability to utilize Rule 134. We note that, when Rule 482 was originally proposed, 24 the Commission considered whether it was necessary for funds to continue to have the option of advertising under Rule 134. In deciding to retain Rule 134 as an option for funds, the Commission reasoned, in part, that an advertisement under Rule 482, unlike an advertisement pursuant to Rule 134, would be a prospectus subject to the more rigorous liability standards under Section 12(2) of the 1933 Act. 25

Moreover, when Rule 482 was adopted in 1979, the adopting release noted that a number of commenters on the proposed rule objected to the fact that all advertisements under Rule 482 would be subject to prospectus liability. In response to these comments, the Commission’s release noted that, because new Rule 482 “is permissive, obviously, investment companies need not make use of the rule if they do not choose to do so. In this regard, in order to make sure that the rule does not, to any extent, supplant Rule 134, the rule explicitly provides that it does not apply to advertisements which are excepted from the definition of prospectus by Section 2(10) of [the Securities Act of 1933] and Rule 134 thereunder.” 26 Under the Commission’s current proposal, Rule 134 would no longer be a permissible alternative to Rule 482 for mutual funds.

We submit that today, as in 1979, the heightened liability standards applicable to Rule 482 ads simply are not warranted in the highly circumscribed universe of ads that qualify to rely on Rule 134. Moreover, we do not believe that the new latitude accorded to investment company advertisements under the proposed amendments to Rule 482 provides a sufficient reason to eliminate the option of relying on Rule 134, particularly absent any indication whatsoever by the Commission that funds have engaged in abusive practices under cover of Rule 134 or that investors’ interests are placed at risk by allowing funds to continue to rely on it.

IV. Applicability of Antifraud Provisions to Fund Advertising

A. Rule 482

The Commission has proposed to add notes to Rule 482 and to Rule 34b-1 under the Investment Company Act clarifying that compliance with the "four corners" of Rule 482 does not relieve an investment company, underwriter, or dealer of its obligation to ensure that the advertising or sales literature is not false or misleading. The Institute supports the inclusion of these notes to these rules. Like the Commission, we believe the substance of these notes is consistent with the Commission's interpretation of Rule 482 since its adoption in 1979. 27

The Institute strongly urges the Commission, however, to confirm in the adopting release that if the performance information in a fund's Rule 482 advertisement (1) is computed in accordance with the methodology required by the rule and (2) complies with the currentness requirements of the rule, the performance information itself (as opposed to other disclosures included in the advertisement) will not be deemed false or misleading. Inasmuch as the rule establishes the methodology for computing performance and specifically addresses the timeliness of performance data, it would be illogical for the Commission to deem fraudulent or misleading performance figures that comply with these express requirements.

B. Proposed Amendments to Rule 156

The Commission has proposed to amend Rule 156 under the Securities Act to add an explicit standard to govern when portrayals of past income, gain, or growth of assets in an advertisement may be misleading. In particular, Rule 156 would be revised to provide that a portrayal of past income, gain, or growth of assets may be misleading if it omits information that is "necessary or appropriate" to make the portrayal not misleading. The Institute recommends that the Commission change the proposed "necessary or appropriate" standard either to "necessary" or to "necessary and appropriate." Our concern with the Commission's proposed standard is that it could be read to require disclosure of information that may be "appropriate," even though such information is not necessary or essential to ensure that the information in the advertisement is not misleading. We believe the standard for determining whether disclosure is required to avoid an advertisement being misleading should be higher than mere appropriateness.

V. Compliance Date

The Commission has proposed to require fund advertisements that are used 90 days or more after the effective date of the amendments to comply with the revised rules. 28 The Commission has sought comment on whether 90 days is an appropriate transition period for compliance. The Institute submits that a 90-day period is insufficient and recommends that the requirements of Rule 482 instead be imposed on all advertisements that contain performance information current to the end of the second full calendar quarter following adoption of the amendments. 29

The proposed revisions to the advertising rules will result in substantial changes to fund advertisements, phone systems, and websites, each of which will necessitate the expenditure of considerable time and resources to ensure compliance with the new requirements. 30 We urge the Commission to provide funds sufficient time to accommodate these sweeping changes. We note that when substantial amendments to Rule 482 were last adopted in February 1988, the Commission also proposed an effectiveness date of approximately 90 days from adoption. This 90-day period, however, was ultimately extended by the Commission to 210 days. 31 While many aspects of the 1988 amendments

went beyond those that are the subject of this proposal, we submit that achieving full compliance within a 90-day period would be at least as difficult for funds as it was in 1988, due to the intervening evolution of websites and the multiplicity of channels used by funds to distribute their funds and performance information.

Further, rather than requiring fund advertisements to be in compliance with the rule after an arbitrary number of days, we believe it would be more appropriate for the compliance date to be based on a calendar quarter end. This approach would recognize that, based on the currentness provisions of Rule 482, advertisements and sales literature that are used on an ongoing basis normally are updated after each quarter end. Otherwise, for all practical purposes, some fund sales material would have to be in compliance with the revised rule prior to the compliance date, 32 which would be inappropriate. Keying the compliance date to passage of two full calendar quarters would avoid this result and provide funds sufficient lead time to comply with the new requirements. 33

* * *

The Institute appreciates the opportunity to provide these comments in response to the Commission's Proposing Release. If you have any questions concerning these comments or would like additional information, please contact the undersigned at 202-326-5824, Frances Stadler at 202-326-5822, or Tamara Reed at 202-326-5825.

Sincerely,

Amy B.R. Lancellotta
Senior Counsel

cc: Paul F. Roye, Director
Susan Nash, Associate Director
Division of Investment Management

ENDNOTES

1 The Investment Company Institute is the national association of the American investment company industry. Its membership includes 8,928 open-end investment companies ("mutual funds"), 499 closed-end investment companies, and six sponsors of unit investment trusts. Its mutual fund members have assets of about $6.898 trillion, accounting for approximately 95 percent of total industry assets, and over 88.6 million individual shareholders.

2 See Release No. 33-8101; 34-45953; IC-25575, dated May 17, 2002 (the "Proposing Release"). The page cites to the Proposing Release herein are to the version available on the Commission's website.

3 See Letter to Paul F. Roye, Director, SEC Division of Investment Management, from Craig S. Tyle, General Counsel, ICI, dated July 18, 2001 (the "2001 ICI Letter").

4 The Institute has long supported stringent regulation to address advertising practices that may mislead or confuse investors. So, for example, the Institute continues to oppose

allowing mutual funds to include in sales material the performance information of another mutual fund previously managed by the advertised fund's portfolio manager while employed by another investment advisory firm. We believe this information could mislead or confuse investors by ignoring the contributions of other investment adviser personnel and of the advisory firm itself to the fund's performance, and implying that the portfolio manager is solely responsible for the fund's performance. See, e.g., Letter to Paul F. Roye, Director, SEC Division of Investment Management, from Craig S. Tyle, General Counsel, ICI, dated March 1, 1999.

5 As discussed in the 2001 ICI Letter and the Proposing Release, such a requirement could result in: an increase in the instances in which performance information for one fund for different periods appeared concurrently as a result of different lead times for different publications; investors according very recent performance greater emphasis than it deserves; and additional substantial costs. See 2001 ICI Letter at pp. 2-3 and the Proposing Release at pp. 12-13.

6 This additional updating would apply to supplemental sales literature under Rule 34b-1 of the Investment Company Act, as well as to Rule 482 material. Rule 34b-1(b)(2) under the Investment Company Act requires that any performance information included in any sales literature used by an investment company meet the currentness requirements of Rule 482.

7 Not only is the proposed three-calendar-day period too short under most normal conditions, but it also could produce absurd results depending on holidays and the day of the week on which the month end falls. For example, in connection with this year's Labor Day holiday (which falls on Monday, September 2), funds would be required, beginning at the close of business on Friday, August 30, to obtain data from third parties, process and test it internally, and provide the required information to their telephone representatives in time for the representatives to provide it to investors by Tuesday, September 3 (i.e., the first day following the August month end on which the firm would be required to provide the August month-end performance numbers). Such a requirement would impose substantial additional personnel costs.

8 The Institute additionally recommends that, if the Commission does impose a specific time period in the rule, such period be based on business days rather than calendar days in order to avoid imposing unreasonable burdens on funds and the employees involved in the process of making the required performance information available.

9 According to the Commission, as of September 2001, 95.1 percent of households had telephone access, while only 50.5 percent had Internet access. See Proposing Release at p. 13.

10 A May 2001 survey by the Institute indicated that 82 percent of mutual fund shareholders had accessed the Internet. See 2001 Profile of Mutual Fund Shareholders, Investment Company Institute (Fall 2001) at p. 4. This percentage increased from 68 percent in April 2000, and 62 percent in 1988. See "Mutual Fund Shareholders' Use of the Internet," Fundamentals, Vol. 9, No. 3, Investment Company Institute (July 2000). Accordingly, while perhaps not all mutual fund investors have access to a computer, we believe that the penetration of computer usage among mutual fund shareholders generally is significant enough to support the Commission permitting funds to provide updated performance information online instead of by phone.

11 We note that in the Initial Regulatory Flexibility Analysis portion of the Proposing

Release, the only costs that would result to small entities from the rule that are discussed are those from the actual production and review of advertising; the Analysis does not take into account the increased expense these funds would incur from having to satisfy the toll-free phone number requirement. See Release at p. 36. As such, the Commission's Analysis likely underestimates the true costs that would be incurred by these smaller fund complexes from this proposal.

12 See proposed Rule 482(g) and Proposing Release at p. 12.

13 The Institute's 2001 letter recommended that a fund that includes the most recent month-end information in its advertisement not be required to provide that data online or via telephone. See the 2001 ICI Letter at footnote 6.

14 A similar result would follow where funds include the current month-end performance information in their print ads. These unintended consequences could especially burden smaller fund complexes.

15 This recommendation would also extend to performance information that is more current than month end. Thus, for example, if a fund advertisement includes performance information current to the end of the most recent week, it should similarly not be required to provide the toll-free phone number.

16 The Institute questions the need for all of the required disclosures to be made in sales material directed to institutional investors. We note that the National Association of Securities Dealers has proposed changes to its rules governing communications with the public to recognize a distinction in the level of protection appropriate for institutional versus retail investors. See 66 Fed. Reg. 67586 (December 31, 2001). The Institute understands that the NASD has received widespread support for amending its advertising rules to recognize a distinction between retail and institutional sales communications. We urge the Commission to consider a similar distinction with respect to the narrative disclosures required under Rule 482.

17 See Proposing Release at p. 15.

18 The Institute reads the statement in the Proposing Release that "[t]he month-end information obtained through a telephone call would not be considered part of the advertisement itself" to mean that the disclosures required by Rule 482 would not need to not be repeated on the phone, inasmuch as a person calling the number already would have seen the disclosures in the sales material containing the toll-free phone number.

19 As proposed in Rule 482(b)(5), the "close proximity" requirement of the rule would apply to the "statements required by paragraph (b)(3)" of the rule. Paragraph (b)(3), which governs the disclosure that must be included in any Rule 482 advertisement containing performance data, would consist of two subparagraphs—subparagraph (b)(3)(i), which would govern the "legend" disclosures, and subparagraph (b)(3)(ii), which would govern the disclosure of information relating to sales loads or other non-recurring fees. According to footnote 82 of the Proposing Release, the "close proximity" requirement would only apply to the legend disclosure required by subparagraph (b)(3)(i). In light of this and to ensure that the proposed rule text is consistent with its explanation in the Proposing Release, the Institute recommends that the reference to paragraph "(b)(3)" in paragraph (b)(5) of the proposed rule be revised to read "(b)(3)(i)."

20 See proposed Rule 482(b)(5).

21 See 2001 ICI Letter at p. 2.

22 Rule 420(a) requires that all prospectuses deemed to be omitting prospectuses under Rule 482 may, in lieu of being in roman type at least as large and as legible as 10-point modern type, be in roman type at least as large and as legible as 8-point modern type and that all such type be leaded at least 2 points. Rule 420(b) requires that an electronic advertisement or sales literature present 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.

23 As proposed, these requirements would apply to all of the following required disclosure: (1) a statement that identifies a source from which an investor may obtain a prospectus and that explains that the prospectus contains more complete information about the fund, including charges and expenses, and should be read carefully before investing; (2) the "subject to completion" legend required by Rule 481(b)(2), if the advertisement is used prior to effectiveness of the fund's registration statement; (3) if the ad includes performance data, that: (a) performance data quoted represents past performance, (b) past performance does not guarantee future results, (c) the investment return and principal value of a fund will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original costs, (d) current performance may be lower or higher than the performance data quoted, (e) the toll-free phone number at which an investor may obtain current month-end performance data, and (f) the maximum amount of any load or nonrecurring fee charged by the fund and information about whether such loads or fees are reflected in the data; and (4) if the fund is a money market fund, the legend required by Rule 482(b)(4).

24 Rule 482 was originally adopted as Rule 434d in 1979. See SEC Release No. 33-6116 (August 31, 1979) 1979 LEXIS 776 ("Release 33-6116"). It was renumbered as Rule 482 without modification in 1982 with the revision of Regulation C under the Securities Act. See SEC Release No. 33-6383 (March 3, 1982).

25 See SEC Release No. 33-5833 (June 8, 1977), 1977 SEC LEXIS 1559 at p. 11.

26 Release No. 33-6116 at p. 7 (emphasis added).

27 See id.

28 According to the Proposing Release, the amendment eliminating the "substance of which" requirement from Rule 482 will take effect immediately upon the effective date of the amendments. The Institute supports the immediate effectiveness of this portion of the proposed amendments.

29 So, for example, if the Commission were to adopt the proposed amendments on October 15, 2002, any fund advertisements containing performance information current as of June 30, 2003 (i.e, the end of the second full calendar quarter following adoption of the rule) would be required to be in compliance with the rule's revised requirements.

30 Also, changes to a fund's ads or sales literature may have to be filed with and approved by the NASD before they can be used, resulting in additional implementation costs and delays.

31 The Commission recognized that 90 days was an insufficient period of time for funds to revise their accounting and computer systems to make the necessary changes and, as a result, this short period of time would create hardships, result in substantial administrative costs that would be passed on to investors, and require certain funds to cease advertising for a period of time, putting them at a competitive disadvantage to other funds. See SEC Release No. 33-6770 (April 25, 1988). See also Investment Company Institute (pub. avail. April 27, 1988). Based upon these concerns and others, in April 1988 the Commission delayed the effectiveness of the amendments until July 1988 and provided further that the Commission would not recommend any enforcement action for funds that were not in compliance with the revised rules until September 1, 1988—i.e., approximately 210 days from their adoption.

32 For example, if we again use the hypothetical rule adoption date of October 15, a 210-day transition period (as was provided in 1988) seemingly would mean that fund ads would have to comply with the revised rule as of approximately May 14. And yet, because May 14 falls in the middle of the second quarter of the year, to be in compliance with the rule as of May 14 would mean that a fund's advertising containing performance information would, in actuality, have to have been compliant when submitted for publication after March 31, the end of the last calendar quarter preceding the compliance date of May 14, if such advertising would still be in use on or after the compliance date. As a result, funds would have only approximately 167 days after the rule's adoption to comply with its requirements.

33 In the event the Commission determines instead to require funds to comply with the revised rules after a certain number of days, consistent with the Commission's experience with the 1988 revisions, we recommend that this period of time be 210 days from adoption of the amendments.