

following improved market performance, commentators have already noted an increase in advertisements highlighting favorable short-term performance and have expressed concern about this practice.⁹ The Commission received 29 comment letters on the proposal. Commenters generally supported the proposal, but also suggested revisions in certain areas.¹⁰ Today, the Commission is adopting these proposed amendments, with certain modifications as described below to address the suggestions of the commenters.

II. Discussion

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

We are adopting, as proposed, the amendment removing the requirement that a rule 482 advertisement contain only information the "substance of which" is included in the statutory prospectus.¹¹ This amendment implements section 24(g) of the Investment Company Act, added by NSMIA, which directs the Commission to adopt rules or regulations that permit registered investment companies to use prospectuses that (i) include information the substance of which is not included in the statutory prospectus, and (ii) are deemed to be permitted by section 10(b) of the Securities Act.¹² Eliminating this

requirement will permit investment companies to include up-to-date information in rule 482 advertisements, such as information about current economic conditions that normally would not be included in a fund's prospectus. The amendment also will permit funds to eliminate certain information from the statutory prospectus, such as boilerplate disclosure about the methods used to calculate performance in fund advertising, that clutters the statutory prospectus and obscures other important information. As a result, investors should receive better, more understandable, and more timely information in both the statutory prospectus and fund advertisements. In addition, the costs of regulatory compliance should be reduced for funds and, ultimately, for investors.

Elimination of the "substance of which" requirement from rule 482 should not diminish investor protection. The "substance of which" requirement is a technical requirement that does not, in itself, prevent misleading statements because it does not require an advertisement to use the same words as the statutory prospectus or prohibit the use of advertising techniques that are not included in the statutory prospectus.¹³ Importantly, rule 482 advertisements, as "prospectuses," will remain subject to liability under section 12(a)(2) of the Securities Act and the antifraud provisions of the federal securities laws. Also, rule 482 advertisements, as section 10(b) prospectuses under the Securities Act, are subject to the summary suspension provisions of section 10(b), which permit the Commission to suspend the use of a materially false or misleading prospectus.¹⁴ In addition, fund advertising materials must continue to be filed with NASD Regulation, Inc. ("NASDR") or the Commission, and NASDR rules relating to fund advertising will continue to apply.¹⁵

improves fund advertising by giving the Commission express authority to create a new investment company 'advertising prospectus'").

¹³ See Investment Company Act Release No. 9811 (June 8, 1977) [42 FR 30379, 30380 (June 14, 1977)] ("1977 Advertising Proposing Release") (proposing rule 434d, subsequently renumbered as rule 482).

¹⁴ 15 U.S.C. 77j(b).

¹⁵ Section 24(b) of the Investment Company Act [15 U.S.C. 80a-24(b)] requires the filing with the Commission of "any advertisement, pamphlet, circular, form letter, or other sales literature" for any registered investment company other than a closed-end fund. Rule 24b-3 under the Investment Company Act [17 CFR 270.24b-3] relieves funds of the obligation to file advertisements and other sales materials with the Commission if those materials are filed with NASDR.

Members of the National Association of Securities Dealers, Inc. ("NASD") also must comply with rule

Finally, we are adopting additional amendments to rule 482 to reinforce antifraud protections, particularly in the area of fund performance.¹⁶

We are using our exemptive authority under the Securities Act to eliminate the "substance of which" requirement from rule 482 for the securities of business development companies ("BDCs") as well as registered investment companies.¹⁷ Currently, BDCs and registered investment companies are treated similarly under rule 482. We believe that it is appropriate to extend the benefits that would result from elimination of the "substance of which" requirement to BDCs, given that elimination of this requirement should not diminish investor protection. We note, however, that BDCs, unlike mutual funds, do not continuously offer and sell their shares and do not make extensive use of advertisements.

We are also adopting amendments removing the provisions of rule 134 that apply specifically to funds and are excluding both registered investment companies and business development companies from relying on rule 134.¹⁸ We believe that, with the elimination of the "substance of which" requirement from rule 482, funds will no longer need to rely on rule 134. Rule 134 will remain available to other issuers. We have made technical modifications to our proposed amendments to rule 134 in order to retain the existing introductory text of rule 134 for these issuers.¹⁹ Rule 482, as amended, will provide funds with sufficient flexibility to discuss topics, such as current economic conditions, that are currently discussed in rule 134 advertisements but generally not in the statutory prospectus. We believe that investor protection will be increased if fund advertisements including this

2210 of the NASD Conduct Rules when sponsoring fund advertisements. Rule 2210 outlines general standards for what may constitute misleading fund advertising and specific requirements for advertising communications. Rules 2210(d)(1) and (2) of the NASD Conduct Rules.

¹⁶ See discussion in Section II.B., "Applicability of Antifraud Provisions to Fund Advertising," and Section II.C., "Enhanced Disclosure Under Rule 482," *infra*.

¹⁷ Section 28 of the Securities Act [15 U.S.C. 77z-3]. Business development companies are a category of closed-end investment companies that are not required to register under the Investment Company Act. See section 2(a)(48) of the Investment Company Act [15 U.S.C. 80a-2(a)(48)] (defining "business development company").

¹⁸ 17 CFR 230.134. Rule 134, in contrast to rule 482, is a content-based rule that specifies certain categories of information that a fund may advertise. Currently, funds may advertise a broad range of information under rule 134, other than performance information. See Proposing Release, *supra* note 7, 67 FR at 36714.

¹⁹ See 17 CFR 230.134(e) (registered investment companies and business development companies excluded from rule 134).

1999 and 2000 focused on extraordinary performance).

⁹ See Kimberly Weisul, *Mutual Fund Ads: Reader Beware*, Business Week, September 15, 2003, at 44; Suzanne McCoy, *Performance Ads Return in Q2 as Spending Drops* (August 12, 2003) <http://www.ignites.com>; Gregg Wolper, *Buy this Fund—It's Had a Great Week!*, Morningstar Online, July 15, 2003, available at <http://news.morningstar.com/doc/document/print/1,3651,93809,00.html>.

¹⁰ The comment letters and a summary of the comments are available for public inspection and copying in the Commission's Public Reference Room, 450 5th Street, NW., Washington, DC 20549-0102. Public comments submitted electronically and the comment summary are also available on the Commission's Internet Web site (<http://www.sec.gov>).

¹¹ The "substance of which" requirement is presently contained in current rule 482(a)(2) [17 CFR 230.482(a)(2)]. We are also revising the language in the note to current paragraph (a)(3) of rule 482, which states that "[t]he fact that the statements included in the advertisement are included in the section 10(a) prospectus does not relieve the issuer, underwriter, or dealer of the obligation to ensure that the advertisement is not false or misleading." [17 CFR 230.482(a)(3)]. The removal of the "substance of which" requirement makes the reference to the section 10(a) prospectus unnecessary. The revised language of this note is incorporated into the note to newly adopted paragraph (a) of rule 482 [17 CFR 230.482(a)]. See Section II.B., "Applicability of Antifraud Provisions to Fund Advertising," *infra*.

¹² 15 U.S.C. 80a-24(g). See also S. Rep. No. 293, 104th Cong., 2d Sess. 8 (1996) (stating that the "bill