

help to remind investors of the limitations of performance data.

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

Nevertheless, in the case of investment companies that do not already voluntarily comply with the requirements of the amendments, the enhanced disclosure requirements provide two benefits to investors. To the extent investment decisions are made based on advertising, the improved disclosure will result in investors making better informed investment decisions, and therefore in a more efficient distribution of assets by investors among different funds. The transparency resulting from the enhanced disclosure in fund advertising may, in turn, also contribute to increased competition among funds and result in a more efficient allocation of resources among competing investment products. Although it is not possible to precisely quantify the beneficial effects of more efficient allocation of investors' assets and increased competition, they may be significant, given the size of the mutual fund industry.⁷²

2. Simplification and Clarification of Fund Advertising Rules

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

The reemphasis of the applicability of the antifraud provisions may help to deter presentation of misleading information in advertisements. The amendments to reorganize rule 482 may aid funds and others in understanding and complying with the advertising rules, making it easier and cheaper for funds to advertise. Both of these

improvements may, in turn, contribute to an increased flow of accurate and useful investment information to investors, which may lead to better-informed investment decisions and amplify the previously discussed benefits of efficient asset allocation.⁷³ Although difficult to quantify, this easing of regulation may provide some reduction of burden to the funds that choose to advertise.

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

To simplify the current structure of fund advertising rules and to provide funds the ability to disclose more timely information in advertisements, the amendments also remove the provision contained in rule 482 limiting advertisements only to that information the "substance of which" is in the statutory prospectus. 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. As a result, the amendments also remove the provisions of rule 134 that apply specifically to funds and exclude both registered investment companies and business development companies from relying on rule 134.

The elimination of the "substance of which" requirement eliminates requirements for funds to include or update advertising related information in their prospectus or SAI, both in the initial registration statements and in post-effective amendments, before issuing an advertisement to the public. This will reduce filing costs for funds, including both internal costs and external costs such as outside legal fees. The amendments will also reduce the costs associated with printing and distributing prospectuses and SAIs. The elimination of unnecessary information from the prospectus or SAIs, because it will remove distracting clutter, may make the remaining information more understandable to investors.

Finally, the rescission of the rule 134 provisions that apply to funds consolidates the regulation of most fund advertising in rule 482, which will cover advertisements now covered by rule 134. This simplification will contribute to the benefits of easier and

cheaper advertising as discussed in section III.A.2 ("Simplification and Clarification of Fund Advertising Rules") above, principally by removing the unnecessary restrictions on the content of the advertisements and the unnecessary distinction with regard to their legal classification. The transfer of fund advertising regulation from rule 134 to rule 482 may also enhance investor protection by subjecting fund advertisements formerly governed by rule 134 to potential civil liability under section 12(a)(2) of the Securities Act.⁷⁴

One commenter disagreed that there would be a benefit to funds as a result of having to comply with only one advertising rule. The commenter stated that, in its experience, there is no correlation between the number of advertising rules and the costs of advertising. We do not believe, however, that this commenter's particular experience negates our conclusion with regard to the potential benefits of simplifying the regulation of fund advertising. In compiling the cost/benefit analysis, the staff found that some funds estimated no savings resulting from the amendments intended to simplify and clarify the advertising rules; these amendments included the rescission of rule 134 as it applies to funds, as well as other amendments such as the removal of the "substance of which" requirement. On the other hand, the staff also found that others did anticipate such a savings. Our estimate below represents an average, overall benefit for all the amendments intended to simplify and clarify the advertising rules and, as such, takes into account those funds that foresee no benefits from the simplification and clarification of the rules.

4. Quantification of Benefits

The Commission estimates that, on an annual basis, the amendments will save funds approximately 1.96 burden hours, or \$73.03, per investment company in internal costs but only negligible amounts in external costs. We estimate that 5,025 investment companies will be affected by the amendments, and, thus, the Commission estimates that the annual internal burden associated with rule 482 will decrease by approximately 9,849 (1.96 hours per investment

⁷³ The trade-off between lower advertising burdens and increased advertising activity is complex and further complicated by business cycles and marketing strategy among other factors. We believe, however, that investors and funds will enjoy benefits in any event—either resources will be saved in reducing the costs and burdens of advertising or they will be spent to increase the amount and timeliness of information provided to investors in advertising.

⁷⁴ The benefits of potential direct investor suits in both remedying fraudulent advertising by funds and deterring such advertising in the future are difficult to quantify, but may be significant. The benefits will be reduced to the extent that the potential liability increases litigation and insurance costs for funds. However, because suits based on misleading advertising are relatively rare, we continue to estimate that the associated costs will be minimal.

⁷² See Investment Company Institute, 2001 *Mutual Fund Fact Book* at 63.