

rule and form amendments under the Securities Act and the Investment Company Act to provide investment companies with the ability to disclose more timely information in advertisements and to reinforce the antifraud protections that apply to investment company advertisements. The amendments implement a provision of NSMIA⁹⁸ by eliminating the requirement in rule 482 under the Securities Act that investment company advertisements contain only information the "substance of which" is included in the statutory prospectus. The amendments also require enhanced disclosure in investment company advertisements and are designed to encourage advertisements that convey balanced information to prospective investors, particularly with respect to past performance. The Commission is also rescinding the provisions in rule 134 under the Securities Act that apply to investment companies.

The Commission prepared an Initial Regulatory Flexibility Analysis ("IRFA") in accordance with 5 U.S.C. 603. The Proposing Release included the IRFA and solicited comments on it. The Commission received one comment specifically addressing the IRFA.

A. Reasons for and Objectives of Amendments

The Commission amended the advertising regulations described above to achieve two separate objectives. First, the Commission is simplifying and clarifying the rules governing fund advertising. Specifically, the amendments remove the "substance of which" requirement of rule 482 and rescind the provisions of rule 134 that apply to investment companies, following Congress' directive in NSMIA to adopt rules or regulations allowing funds the use of a section 10(b) prospectus that may include information the substance of which is not included in the statutory prospectus.⁹⁹ We are also adopting technical amendments to reorganize and clarify the language of rule 482. These simplifying and clarifying amendments will aid funds and others in understanding and complying with the advertising rules, making it easier and cheaper for funds to advertise.

Second, the Commission is enhancing the disclosure required in rule 482 advertising. Specifically, we are requiring rule 482 advertisements to: (i) Highlight the availability of certain

additional information, such as that regarding objectives, risks, charges, and expenses, as well as updated monthly performance figures; (ii) provide an amended legend; and (iii) present certain required disclosure with prominence equal to the major portion of the advertisement. We are adopting these amendments because of our concern about fund performance advertising that could create unrealistic investor expectations or even mislead potential investors. The enhanced disclosure requirements will help to ensure that investors find advertising clear, easy to use, and balanced, and that investors are made aware of important and timely information necessary to make informed investment decisions.

B. Significant Issues Raised by Public Comment

The Commission requested comment with respect to the IRFA prepared and published with the Proposing Release. Two commenters indicated that the cost of complying with the proposed requirement that updated information be made available through a toll-free or collect telephone number would be particularly burdensome for smaller fund complexes, stating that some smaller complexes do not already have automated voice response systems. The commenters cited costs of buying and maintaining an automated telephone system or dedicating employees to provide the required information. One of these commenters, the only commenter who specifically addressed the IRFA, also stated that the IRFA likely underestimated the costs that small fund complexes would incur from having to satisfy the requirement that updated monthly information be provided by a toll-free or collect telephone number.¹⁰⁰ One commenter indicated that making updated monthly performance data available in the manner contemplated by the proposal would be affordable for all funds, regardless of size.

None of the commenters provided additional data or figures to quantify this cost.¹⁰¹ The commenters did not

indicate either the number of small funds that would need to set up a telephone system (versus those that already have such a system in place that could be adapted to meet the proposed requirements) or how much small funds may have to pay to establish and maintain such systems.

C. Small Entities Subject to the Rule

For purposes of the Regulatory Flexibility Act, an investment company is a small entity if it, together with other investment companies in the same group of related investment companies, has net assets of \$50 million or less as of the end of its most recent fiscal year.¹⁰² Approximately 237 out of 5025 investment companies meet this definition.¹⁰³

The Commission estimates, based on the staff's discussions with members of the fund industry, that approximately two-thirds of small entity funds do not advertise and, thus, do not incur any burdens or costs associated with rule 482. For small entity funds that do advertise, the Commission estimates an internal hour burden of approximately 80 hours per small entity fund. This represents approximately 6,320 (80 hours x 79 small entities) hours, or \$235,483 (6,320 hours x \$37.26 wage rate) in internal costs, for all small entities. The Commission estimates that the external cost burden associated with rule 482 for small entities, as with other funds, is negligible. To the extent small entities currently advertise, the burden and costs may affect them to a greater extent because small entities are unable to take advantage of economies of scale available to larger fund complexes.¹⁰⁴

commenter cited this estimate and stated that it is for hardware and software requirements only and does not include personnel expenses. The commenter also stated that expenses for companies that do not presently have automated telephone systems would likely be several times higher than the estimate provided. Neither of these commenters specifically addressed the issue of costs incurred by small entities. Both were focusing on the costs of a system that insurance companies would use to provide information about funds underlying their variable insurance products.

¹⁰² 17 CFR 270.0-10.

¹⁰³ This estimate is based on figures compiled by the Commission staff regarding investment companies registered on Form N-1A, N-2, N-3, N-4, and N-6. In determining whether an insurance company separate account is a small entity for purposes of the Regulatory Flexibility Act, the assets of insurance company separate accounts are aggregated with the assets of their sponsoring insurance companies. 17 CFR 270.0-10(b). Currently, no insurance company separate account filing on Form N-3, Form N-4, or Form N-6 qualifies as a small entity.

¹⁰⁴ We note, however, that to the extent that the amendments reduce the regulatory burden of advertising, small entities may be encouraged to increase their advertising activity.

⁹⁸ National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416, 3428, Section 204.

⁹⁹ *Id.*

¹⁰⁰ The commenter stated that the only costs that the IRFA discussed for small entities were those of actual production and review of advertising. However, the IRFA also refers to other one-time switchover costs that would result from the rule and recognizes that these costs may have a relatively greater effect on small entities. The IRFA states that among these costs are those of making available updated monthly performance data by a toll-free telephone number. Proposing Release, *supra* note 67 FR at 36731.

¹⁰¹ One commenter estimated the cost of implementing an automatic voice response system for fund performance at \$500,000. Another