
Chapter 9

Investment Company Advertising

I. Introduction and Summary of Recommendations

Investors today have a complex range of financial products and services from which to select, and competition is fierce among the many providers of financial services for investors' dollars. To compete effectively in this market, financial service providers, including investment companies and their sponsors, use advertising to inform the public about their products and services.

Like most issuers of securities, when a mutual fund or other investment company offers its shares to the public, its promotional efforts become subject to the advertising restrictions of the Securities Act of 1933.¹ Congress imposed these restrictions so that investors would base their investment decisions on the full disclosures contained in the "statutory prospectus,"² which Congress intended to be the primary selling document. Originally, the reach of the advertising restrictions was formidable. The Securities Act essentially prohibited all advertising other than the statutory prospectus and limited announcements called "tombstones," which only identified the existence of offerings and provided information on how to obtain a prospectus. Under current law, investment companies may advertise using certain types of information if the advertisements comply with certain "safe harbor" rules.

The advertising restrictions of the Securities Act cause special problems for many investment companies. Mutual funds continuously offer and sell their shares to provide an ongoing flow of capital into their portfolios and to enable them to meet redemption requests from outgoing shareholders. Unit investment trusts ("UITs") have active secondary markets in which the trusts' sponsors are continuously redeeming and selling the trusts' units.³ These ongoing distribution practices contrast sharply with the more traditional underwritings in which set amounts of capital are raised through periodic offerings of limited duration. In

¹Securities Act of 1933, 15 U.S.C. §§ 77a-77aa. See Section II.A. of this chapter for a discussion of the pertinent Securities Act provisions.

²As used in this chapter, "statutory prospectus" means the full prospectus required by section 10(a) of the Securities Act, 15 U.S.C. § 77j(a). "Section 10 prospectus" refers to any prospectus permitted under any subsection of section 10, and is not limited to a section 10(a) prospectus.

³See *infra* text accompanying note 29.

the case of the latter, the advertising restrictions end with the offering. In the case of mutual funds and UITs, the advertising restrictions never end because the offering process, in effect, never ends.

In addition, because of the nature of their business, the effect of the advertising restrictions is more severe for investment companies than for other types of companies. Other companies, even when engaged in a public offering, are able to advertise their products, and thus gain name recognition with potential investors, because advertising that does not attempt to sell securities is not subject to the Securities Act. Investment companies, in contrast, do not sell products in the usual commercial sense. In fact, the very nature of an investment company is so inextricably tied to the securities it offers that almost any advertisement about the company is potentially an offer to sell its securities that must conform to the Securities Act's requirements.

The advertising restrictions of the Securities Act also affect direct-marketed funds more than funds sold through broker networks. Direct-marketed funds use print, radio, and television advertising almost exclusively to sell fund shares to investors, while broker-sold funds employ sales personnel who sell fund shares orally. The advertising restrictions of the Securities Act have a much greater impact on direct-marketed funds than on broker-sold funds because the Securities Act does not hold the oral representations of sales personnel to the same prospectus requirements⁴ as it does written communications?

In recognition of these problems, and to better enable investment companies to market themselves, the Commission has adopted advertising safe harbor rules. The most important of these is rule 482, which permits investment companies to advertise investment performance data.⁶ Rule 482 advertisements, however, are "prospectuses" under section 10(b) of the Securities Act (so-called "omitting prospectuses")? which means that they may only contain information

⁴As discussed *infra* at text accompanying note 52, however, oral representations are subject to the liability provisions of section 12(2) of the Securities Act.

⁵See *infra* text accompanying notes 20, 28, and note 70. In this chapter, "written" communications, advertisements, sales material, and offers include those made by means of print, radio, television, and any other means contemplated by section 2(10) of the Securities Act. 15 U.S.C. § 77b(10).

⁶17 C.F.R. § 230.482.

⁷15 U.S.C. § 77j(b).

"the substance of which" is included in the statutory prospectus: and that they are subject to section 12(2) of the Securities Act,⁹ which imposes liability for false or misleading statements of material fact ("prospectus liability"). Rule 134, the so-called "tombstone rule,"¹⁰ stands in contrast. Over the years the Commission has expanded this safe harbor to the point where today investment company tombstones may contain almost any type of information other than performance data. The expansion of rule 134 raises investor protection concerns. Unlike rule 482 advertisements, there is no requirement that the substance of tombstone advertisements be contained in the statutory prospectus. In addition, because tombstone advertisements are not prospectuses, they are not subject to section 12(2).

In view of the impact that the Securities Act's advertising requirements have on investment companies, and in view of the anomalous and not wholly satisfactory evolution of the advertising safe harbor rules, the Division has considered whether the Securities Act's advertising requirements should be modified as they apply to investment companies. After reviewing the public comments and considering a number of alternatives, the Division recommends replacing the rule 482, omitting prospectus with a new section 10 "advertising prospectus" for investment companies.¹¹ This investment company advertising prospectus, like the current rule 482 prospectus, would be permitted to advertise performance data. Unlike the rule 482 prospectus, however, the investment company advertising prospectus would not be limited to information "the substance of which" is contained in the statutory prospectus. Eliminating this requirement would permit investment companies to advertise more freely and creatively, and would result in the dissemination of more information to the investing public.

⁸See 17 C.F.R. § 230.482(a)(2). This requirement stems directly from the status of rule 482 advertisements as "omitting prospectuses" under section 10(b). See *infra* note 54 and accompanying text.

⁹15 U.S.C. § 77l(2).

¹⁰17 C.F.R. § 230.134.

¹¹The Commission would accomplish this either by amending rule 482 or by rescinding rule 482 and adopting a new rule. Because section 10(b) of the Securities Act only permits a prospectus "which omits in part or summarizes information in the [statutory] prospectus," and because the proposed investment company "advertising prospectus" arguably will not comply with this requirement, the Division recommends amending section 10 to give the Commission the express authority to adopt this new advertising prospectus.

The Commission would maintain or increase the current level of investor protection by developing standards governing the content and other aspects of investment company advertising prospectuses. With respect to the advertisement of performance information in particular, the Commission will determine whether the standards in rule 482 are sufficient, or whether, given the elimination of the "substance of" requirement and the broader advertising that will ensue, additional standards are needed. In addition, because the investment company advertising prospectus will be a "prospectus" as defined in section 2(10) of the Securities Act, the information contained therein will continue to be subject to the liability provisions of section 12(2) of the Securities Act. Finally, investment companies will still be required to deliver the statutory prospectus to investors prior to, or with, the earlier of the confirmation of the sale or the delivery of the security.¹²

In connection with the proposal for an investment company advertising prospectus, the Division also proposes rescinding those provisions of rule 134 that are applicable to investment companies only. The Division believes that much of the information currently advertised by investment companies in rule 134 tombstones would be more appropriately advertised in the new investment company advertising prospectuses, which would be subject to section 12(2).

The Division considered, but does not recommend, permitting investment companies to advertise subject only to the antifraud provisions of the Securities Act and the Securities Exchange Act of 1934.¹³ The Division believes that investors should continue to have an express private right of action, subject to a reasonable care defense, as provided by section 12(2) of the Securities Act.¹⁴ Eliminating this private right of action would, in effect, require investors that are harmed by misleading advertisements to sue under rule 10b-5, which requires investors to prove "scienter" or an intent to deceive.¹⁵ This would reduce the ability of investors to recover on the basis of misleading advertisements, and thus significantly weaken investor protection.

The Division also recommends that the Commission permit mutual funds to sell their shares "off-the-page," which would be similar to a practice currently permitted in the United Kingdom and certain other European countries. The advertising restrictions of the Securities Act unintentionally have had disparate effects on direct-marketed funds in relation to broker-sold funds, and, as a result,

¹²See *infra* note 24 and accompanying text.

¹³Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78ll.

¹⁴See *infra* note 50 and accompanying text.

¹⁵17 C.F.R. § 240.10b-5. See also *infra* note 53 and accompanying text.

have put direct-marketed funds at a competitive disadvantage. "Off-the-page" advertisements would help address this problem.

Off-the-page advertisements (which, under the legislation we recommend, would be a form of "advertising prospectus") would allow investors the option of purchasing mutual fund shares directly from an advertisement by completing an application form included with the advertisement. Investors that choose to review the statutory prospectus before investing would complete a request form that also would be included with the advertisement. The advertisement would continue to be subject to liability under section 12(2) of the Securities Act and would be required to contain core information about the investment company, as the Commission prescribes by rule, such as historical performance data, levels of fees and expenses, and investment objectives. The investment company would still be required to deliver the statutory prospectus to investors prior to, or with, the earlier of the confirmation of the sale or the delivery of the security.

The Division believes that an off-the-page rule would produce better and more informative advertisements. Because core information about the funds would be standardized in advertisements for the first time, investors would have access to a new, widely circulated source of important information that could be used to make comparative judgments about their investment alternatives. Investors that wish to study the statutory prospectus before making an investment decision would receive it before investing, but investors that choose to purchase off-the-page would receive the statutory prospectus along with written confirmation of the sale. This practice would parallel the current requirements that apply to brokers who may sell securities by means of oral, rather than written, communications.

As an alternative, the Division considered whether the statutory prospectus should be required to be delivered prior to all mutual fund sales, including sales made on the basis of oral communications. The Division does not recommend this because the statutory prospectus is easily available to investors upon request and because the requirement would disrupt longstanding practice. In the absence of evidence that investors are dissatisfied with, or are being harmed by, the current system, an inflexible advance prospectus delivery requirement does not seem warranted.

This chapter begins by analyzing the current application of the Securities Act and the rules thereunder to investment company advertising. Next, it considers whether certain restrictive conditions in rule 482 should be eliminated and whether investment companies should be permitted to sell off-the-page. The chapter concludes with a brief discussion of other proposals the Division considered.

11. Background

A. Application of the Securities Act and Rules to Investment Company Advertising

1. General Considerations

When Congress enacted the Investment Company Act of 1940,¹⁶ the Securities Act already regulated the offer and sale of investment company securities. While the Investment Company Act contained provisions that either supplemented the Securities Act or harmonized the scheme of regulation under the two statutes, it did not make any fundamental changes in the way investment companies could distribute their shares to the public. As a result, even though investment companies, particularly mutual funds, almost certainly were not the type of issuer Congress had foremost in mind when drafting the Securities Act, investment companies continued to be subject to its provisions.¹⁷

The central provision of the Securities Act, section 5,¹⁸ contains prohibitions regarding the use of interstate commerce to offer and sell securities to the public. Absent an exemption, under section 5(c) it is illegal for an issuer or underwriter to offer a security for sale to the public using jurisdictional means until a registration statement is filed with the Commission.

Section 5 also contains prohibitions regarding the dissemination of written selling material to investors during the offering period. Section 5(b)(1) makes it unlawful to use interstate commerce to transmit any prospectus relating to a security with respect to which a registration statement has been filed unless the prospectus meets the requirements of section 10 of the Securities Act.¹⁹ "Prospectus" is broadly defined in section 2(10) to include any advertisement or other communication, "written or by radio or television, which offers any security

¹⁶Investment Company Act of 1940, 15 U.S.C. § 80a.

¹⁷One possible explanation is that the predominant form of investment company in existence in 1940 was closed-end. See Chapter 11. Unlike open-end companies, closed-end companies usually engage in traditional underwritten offerings of a fixed number of shares, and in most cases do not offer their shares to the public on a continuous basis.

¹⁸15 U.S.C. § 77e.

¹⁹Section 10 and Schedule A of the Securities Act set forth specific information required in section 10 prospectuses, as modified by the rules and regulations of the Commission adopted pursuant to its powers under section 10.

for sale or confirms the sale of any security."²⁰ Thus, advertisements are considered prospectuses under the Securities Act if they offer a security for sale. Because the term "offer" is defined and interpreted broadly to encompass any attempt to procure orders for a security,²¹ written advertisements relating to a security or aiding in the selling effort with respect to a security generally must be in the form of a section 10 prospectus.

Investment companies primarily use two types of section 10 prospectuses: the statutory prospectus specified in section 10(a); and a prospectus permitted under section 10(b) that "omits in part or summarizes" information in the section 10(a) prospectus.²² A security cannot actually be sold until the registration statement becomes effective,²³ and the section 10(a) prospectus must be delivered no later than the delivery of the security or the confirmation of the sale, whichever occurs first.²⁴

There is a limited exception to the general requirement that written offers after the filing of a registration statement must be in the form of a section 10 prospectus. So-called "supplemental sales literature" may be used after the effective date of a registration statement if accompanied or preceded by the statutory prospectus.²⁵ Thus, advertisements not meeting the requirements of section 10 may be used after the effective date if the statutory prospectus is printed in the advertisement (or was sent previously to each person receiving the advertisement). In addition, the use of specific types of advertisements such as "tombstone" advertisements are permitted under very limited circumstances,

²⁰15 U.S.C. § 77b(10).

²¹Section 2(3) defines the term "offer" to include "every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value." 15 U.S.C. § 77b(3). See, *also, e.g.*, In the Matter of Carl M. Loeb, Rhodes & Co., 38 S.E.C. 843,848 (1950) (holding that the statutory definitions of "offer" and "prospectus" are intentionally broad so as to include any document designed to procure orders for a security).

²²For a discussion of summary and preliminary prospectuses, see discussion *infra* at notes 43-44 and accompanying text, and note 70. See *also infra* note 58 for a discussion of generic advertisements and newsletters.

²³Securities Act § 5(a), 15 U.S.C. § 77e(a).

²⁴See Securities Act §§ 2(10), 5(b)(1)-(2), 15 U.S.C. §§ 77b(10), 77e(b)(1)-(2).

²⁵Under section 2(10)(a), supplemental sales literature is not considered to be a prospectus, and thus is not subject to section 5(b)(1) of the Securities Act. **Many** investment companies use supplemental sales literature extensively, often as an insert in the prospectus.

without prior delivery of the statutory prospectus.

The advertising restrictions and the prospectus delivery requirements are intended to foster an environment for making rational decisions based on the full disclosures contained in the filed registration **statement**.²⁶ The requirements also are intended to limit the potential for high pressure salesmanship, undue expectations, and appeals to emotion in the sale of securities.²⁷ It is possible, however, under the Securities Act to sell a security orally and to send the statutory prospectus later, either with the security or the confirmation of the sale (whichever is earlier), because section 5(b)(1) limits only the use of a prospectus, and "prospectus" is defined to include written -- but not oral -- communications. Thus, investors do not necessarily receive full, written disclosure before they decide to purchase a **security**.²⁸

As discussed above, many investment companies are continuously subject to the advertising restrictions of the Securities Act. Mutual funds engage in continuous offerings. UITs are continuously subject to the Securities Act because the trusts' sponsors typically operate secondary markets in which sponsors offer to buy back trust units from existing unit holders and sell them to new unit holders. Because the sponsor, as the trust's depositor, is an "issuer" under section 2(4) of the Securities Act,²⁹ all offers and sales by the sponsor in the secondary market, unless otherwise exempt, are subject to the Securities Act.

The greater impact of the Securities Act on these investment companies compared to other issuers cannot be traced to any particular congressional concern. Instead, it is simply a product of a statute that treats issuers that distribute their shares continuously the same as issuers that distribute their shares periodically.

2. The Advertising Rules Before 1954

When Congress passed the Securities Act, securities professionals were reluctant to disseminate any written material about an offering for fear it would

²⁶See FEDERAL SUPERVISION OF TRAFFIC IN INVESTMENT SECURITIES IN INTERSTATE COMMERCE, H.R. REP. No. 85, 73d Cong., 1st Sess. 8 (1933) [hereinafter 1933 HOUSE REPORT].

²⁷See *id.* at 2.

²⁸The Commission has imposed requirements to encourage the pre-sale distribution of preliminary prospectuses, but the requirements do not affect the vast majority of mutual fund sales. See *infra* note 70 .

²⁹15 U.S.C. § 77b(4).

constitute an illegal offer?' Practitioners found it difficult to distinguish between disseminating information, which was permitted and encouraged, and solicitation, which was prohibited.

Within months of the Securities Act's passage, and continuing for years afterward, regulators provided guidance on the dissemination-solicitation distinction in the form of public releases. **An** early release originated the "red herring" theory, under which circulars, describing the security in the manner required for prospectuses but marked to show that they were informative only and did not offer any security for sale, could be used prior to the effective date of the registration statement.³¹ Later, the red herring theory was extended to permit the dissemination of certain summaries, such as the "blue card" summaries prepared by statistical organizations.³² Eventually, the Commission adopted a rule specifically providing for **the** use of red herring prospectuses on the theory that they did not offer a security for sale within the meaning of section 2(3) of the Securities Act.³³

In addition to red herrings, certain advertisements could be circulated under a narrow exception contained in section 2(10)(b) of the Securities Act. That exception provided for a tombstone advertisement which stated from whom a section 10 prospectus could be obtained and, in addition, did no more than identify the security, state the price thereof, and state by whom orders would be executed.³⁴ The tombstone was regarded as a "mere announcement" that did not interfere with the intent of Congress that investors have a complete understanding of the transactions in which they were invited to participate.³⁵

³⁰Originally the Securities Act prohibited all offers until the registration statement became effective.

³¹Offers of Sale Prior to Effective Date of Registration Statement, Securities Act Release No. 70, 1 Fed. Sec. L. Rep. (CCH) ¶ 3150 (Nov. 6, 1933).

³²Distribution by Statistical Services of Bulletins Describing Securities, Securities Act Release No. 464, 1 Fed. Sec. L. Rep. (CCH) ¶ 3165 (Aug. 19, 1935); Circulation of Information in Registration Statements Prior to their Effective Date, Securities Act Release No. 802, 1 Fed. Sec. L. Rep. (CCH) ¶ 3175 (May 23, 1936).

³³Adoption of Rule 131, Securities Act Release No. 3177, [1945-1947 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 75,720 (Dec. 5, 1946).

³⁴Tombstones are not prospectuses under section 2(10) and thus are not subject to section 5(b)(1). See *supra* text accompanying note 20.

³⁵See 1933 HOUSE REPORT, *supra* note 26, at 8.

In the early 1950's, the Commission used its rulemaking powers to permit issuers to advertise in a context other than the limited statutory tombstone. The Commission adopted a rule providing for an "identifying statement," which resembled an expanded tombstone.³⁶ An identifying statement could contain up to sixteen categories of information (as opposed to three or four for tombstones), but was only required to contain a red herring-type legend and a tear-off form for requesting the statutory prospectus. According to Professor Louis Loss, issuers did not use identifying statements, particularly complete identifying statements, very often in newspaper advertisements, except for mutual funds which adapted the tear-off form to their traditional tombstone advertisements.³⁷

The Commission at that time also adopted a more expansive rule providing for a "newspaper prospectus" to be used by foreign governments? Unlike identifying statements, newspaper prospectuses could contain any information "the substance of which" was included in the registration statement. Eventually the Commission adopted procedures permitting certain qualified domestic issuers (but not investment companies) to use newspaper prospectuses. In many ways the newspaper prospectuses (which are still available today to foreign governments)³⁹ were very similar to modern day "summary prospectuses."⁴⁰

3. Post-1954 Development of Special Rules for Investment Companies

Uncertainty among securities professionals regarding the use of written communications in connection with public offerings continued until 1954 when

³⁶Securities Act Release No. 3453 (Oct. 1, 1952), 17 FR 8898 (adopting rule 132). The theory underlying rule 132 was the same as the theory underlying the red herring, *i.e.*, that the advertisement was not an offer under section 2(3).

³⁷1 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 402, n.47 (3rd ed. 1989). This adaptation was possible because of the overlap in the information permitted by the rule and the statutory tombstone exception. An advantage of the identifying statement was that it could be used before and after the effective date of the registration statement, whereas, at the time, tombstones were limited to the post-effective period. The distinction, however, held little significance for mutual funds because they did -- and still do -- most of their selling in the post-effective period.

³⁸Newspaper Prospectuses for Foreign Governments, Securities Act Release No. 3425 (Aug. 27, 1951), 16 FR 8820. Newspaper prospectuses differed from identifying statements in that they could be used only in newspapers or periodicals after the effective date of the registration statement and were required to contain specific types of information.

³⁹See 17 C.F.R. § 230.494.

⁴⁰See *infra* notes 43-44 and accompanying text.

Congress significantly amended the Securities Act.⁴¹ Congress amended section 5 to permit offers during the so-called "waiting period," *i.e.*, the period after a registration statement is filed but before it becomes effective. This largely solved the dissemination-solicitation problem.⁴² In addition, Congress added rulemaking authority to section 2(10)(b), permitting the Commission to adopt rules specifying additional types of information that could be included in tombstone advertisements, and amended section 10(b), directing the Commission to adopt rules providing for a prospectus that "omits in part or summarizes" information in the statutory prospectus. These changes codified the prior administrative actions taken by the Commission and set the stage for further rulemaking.

Shortly thereafter, the Commission used its new rulemaking authority in section 10(b) to adopt rules providing for summary prospectuses.⁴³ Investment companies, however, were not permitted to use summary prospectuses until 1972 when the form for registering mutual funds was amended to provide for their use. Even then, the summary prospectuses were required to contain a substantial amount of information that made their use impractical for advertising in mass media.⁴⁴

⁴¹Ch. 667, 68 Stat. 683 (1954).

⁴²The dissemination-solicitation debate centered mostly on whether a communication constituted "jumping the gun," *i.e.*, making an offer before the offer legally could be made. Even after Congress legalized offers in the waiting period, a problem continued to exist in terms of discerning whether a communication was an offer, because, if a communication was an offer, it had to be in a permissible form.

⁴³Adoption of Rule 434, Securities Act Release No. 3592, [1952-1956 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,371 (Nov. 10, 1955) (permitting blue card summaries); Adoption of Summary Prospectus Rule 434A and Amendments to Forms S-1 and S-9, Securities Act Release No. 3722, [1952-1956 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,415 (Nov. 26, 1956) (merging the concept of summary prospectus with the old concept of newspaper prospectus). In 1982, a new summary prospectus rule, rule 431, replaced the earlier rules. Adoption of Integrated Disclosure System, Securities Act Release No. 6383 (Mar. 3, 1982), 47 FR 11380. 17 C.F.R. § 230.431.

⁴⁴Investment Company Advertising and Summary Prospectus for Investment Companies, Securities Act Release No. 5248 (May 9, 1972), 37 FR 10071. For current summary prospectus requirements for mutual funds, see Instructions as to Summary Prospectuses contained in Form N-1A, Fed. Sec. L. Rep. (CCH) ¶ 51,207.

The Commission also exercised its rulemaking authority under section 2(10)(b) to adopt rule **134**, the tombstone rule.⁴⁵ The legislative history of the 1954 amendments to section 2(10)(b) demonstrates that Congress believed that the rulemaking power was needed to permit "appropriate variation" in the contents of tombstone advertisements with safeguards.⁴⁶ The legislative history indicates, however, that Congress still intended tombstone advertisements to be a simple means for soliciting inquiries for the statutory prospectus. Accordingly, when the Commission adopted rule **134**, the newly expanded tombstone advertisements still were quite limited in scope. They could not contain financial information, general descriptions of the issuer, or other information that might reflect the desirability of buying the security.

Because of these limitations, rule **134** was not very useful to investment companies until the Commission amended it, first in 1972⁴⁷ and again in 1974.⁴⁸ These amendments permitted tombstone advertisements to contain a description of a mutual fund's particular attributes and method of operation, as well as limited financial information such as net asset value as of the most recent practicable date. In 1975, the Commission again amended the rule to allow discussions of general economic conditions (e.g., inflation) as well as references to retirement plans or other specific investment goals that could be achieved through an investment in the fund.⁴⁹

Today investment companies can include a broad range of information in rule **134** advertisements. Essentially the only information that investment companies may not include under rule **134** is performance information.

The almost annual amending of rule **134** in the early to mid-1970's reflected the tension between the desire of investment companies to advertise more and broader topics of information and the theory that the tombstone was a simple device for screening out investors interested in obtaining a prospectus. This tension intensified in the late 1970's, and the Commission came under increasing

⁴⁵Adoption of Rules 134 and 135, Securities Act Release No. 3568, [1952-1956 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,359 (Aug. 29, 1955). At the same time, the Commission rescinded the identifying statement rule, because rule 134 made that rule unnecessary.

⁴⁶H.R. REP. NO. 1542, 83d Cong., 2d Sess. 22 (1954); S. REP. NO. 1036, 83d Cong., 2d Sess. 6 (1954).

⁴⁷Sec. Act Rel. 5248, *supra* note 44.

⁴⁸Investment Company Advertising and Statement Required in Prospectus, Securities Act Release No. 5536 (Nov. 4, 1974), 39 FR 39868.

⁴⁹Investment Company Advertising, Securities Act Release No. 5591 (June 16, 1975), 40 FR 27442.

pressure to permit the inclusion of performance information in tombstone advertisements.

The Commission was reluctant, however, to expand the tombstone rule further without imposing prospectus liability under section 12(2) of the Securities Act for false or misleading statements of material fact.⁵⁰ Because tombstones are excepted from the definition of prospectus, they do not appear to create liability under the two express private causes of action in the Securities Act for material misstatements and omissions. Section 11 applies only to effective registration statements (which include the statutory prospectus);⁵¹ section 12(2) by its terms applies only to prospectuses (both statutory and otherwise) and oral communications.⁵² Thus, sponsors, issuers, and underwriters using misleading tombstones probably are subject to private liability only if they act fraudulently or recklessly.⁵³

The resolution of these tensions came in 1979 with the adoption of the so-called "omitting prospectus" rule, now rule 482, under the rulemaking power in

⁵⁰Section 12(2) imposes liability on persons who offer or sell a security in interstate commerce by means of a prospectus or oral communication which includes an untrue statement of material fact, or omits to state a material fact that is necessary under the circumstances in order to make the statements made not misleading, subject to a defense that the offeror/seller did not know and, in the exercise of reasonable care, could not have known, of the untruth or omission.

⁵¹Section 11 imposes liability not on sellers of securities but on issuers of securities, as well as a broad range of other persons including directors, underwriters, and consenting experts, such as accountants, for information contained in the effective registration statement. 15 U.S.C. § 77k. There are certain other differences between section 11 and section 12. For example, under section 11 issuers do not have the "reasonable care" defense that they have under section 12(2). For an in-depth discussion and comparison of liability under sections 11 and 12(2), see LOUIS Loss, FUNDAMENTALS OF SECURITIES REGULATION 887-906 (2d ed. 1988).

⁵²But see LOSS, supra note 51, at 892 n.19. Professor Loss raises the problem of a seller who uses the statutory prospectus, which tells the whole truth, but sends along supplementary selling literature (which, like tombstones, are not prospectuses) containing "a pack of lies." He finds it hard to believe a court would exalt a "drafting bug" over clear legislative intent and deny recovery under section 12(2).

⁵³To prevail in a lawsuit under rule 10b-5 under the Exchange Act (which applies to tombstones), a plaintiff must prove that the defendant acted with *scienter*. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976). Although section 17(a) of the Securities Act (15 U.S.C. § 77q(a)) essentially prohibits negligent misstatements or omissions in tombstones, most courts and commentators believe that an implied private right of action does not exist under section 17(a). See generally Loss, supra note 51, at 975-981.

section 10(b) of the Securities Act.⁵⁴ Rule 482 permits investment companies to advertise any information "the substance of which" is included in the statutory prospectus. The "substance of" requirement relates directly to the word "omits" in section 10(b) of the Securities Act, upon which authority for the rule rests. The theory behind the "substance of" requirement is that an advertisement cannot be one that "omits" information from the statutory prospectus unless all of the information in the advertisement is derived from (*i.e.*, is the "substance of") information in the statutory prospectus.

The most significant effect of adopting the rule under section 10(b) of the Securities Act, rather than section 2(10)(b), was to attach private liability under section 12(2) for false or misleading statements in rule 482 advertisements.⁵⁵ Because advertisements under rule 482 are prospectuses, they carry liability under section 12(2), subject only to a reasonable care defense.

B. The Interplay of Rules 482 and 134

In the fifty-two years since the enactment of the Investment Company Act, Congress and the Commission have attempted to accommodate the unusual requirements of investment companies within the federal securities laws. The result now is a somewhat anomalous situation in which one kind of advertisement, the rule 134 tombstone, may be used to promote investment company shares creatively, perhaps even irresponsibly, subject only to the antifraud provisions and to the prohibition against the inclusion of any performance information. While the rule 482 omitting prospectus advertisement may use performance information, the substance of the information also must be in the statutory prospectus, and is subject to the stricter liabilities of section 12(2) of the Securities Act.

Moreover, although rule 482 permits mutual funds to advertise performance information, they may do so only because of an attenuated link to the "substance of" requirement. To make the rule workable, investment companies have not been required to put actual performance figures in the statutory prospectuses, which would have resulted in investment companies constantly having to "sticker" their section 10(a) prospectuses. Rather, advertisements are deemed to meet the "substance of" standard of rule 482 as

⁵⁴Advertising by Investment Companies, Securities Act Release No. 6116 (Aug. 31, 1979), 44 FR 52816.

⁵⁵Section 10(b) of the Securities Act by its terms provides that section 10(b) prospectuses, even if filed with the registration statement, do not create liability under section 11 of the Securities Act. Section 11 imposes a tougher standard of liability on issuers of securities than section 12 imposes on sellers because, under section 11, issuers have strict liability. See *supra* notes 50-51.

long as the section 10(a) prospectus describes the methodology used to calculate the performance figures.⁵⁶

The interplay between rule 134 and rule 482 has some ironic and unintended consequences. When reviewing advertisements, employees of the National Association of Securities Dealers, Inc. must try to discern which rule the sponsor is or should be relying upon to publish the advertisement.⁵⁷ As a practical matter, the only distinguishing feature is the inclusion or absence of performance information. If an advertisement contains such information, it must conform to rule 482's requirements, including the "substance of" requirement. If an advertisement does not contain performance data, it may be subject only to rule 134.⁵⁸

11. Recommendations

A. "Investment Company Advertising Prospectuses"

The Division recommends replacing the rule 482 omitting prospectus with a new section 10 advertising prospectus, to be called an "investment company advertising prospectus" or "advertising prospectus." The salient feature of this new advertising prospectus is that, unlike a rule 482 omitting prospectus, the information contained therein would not be limited to information the "substance of which" is contained in the statutory prospectus. Eliminating this requirement will remove a substantial regulatory burden, and should permit investment companies to advertise more freely and to disseminate valuable information to investors.

⁵⁶See Dechert Price & Rhoads (pub. avail. Nov. 20, 1979).

⁵⁷For the rules governing the filing of advertisements with the NASD, see Securities Act rule 497(i) (17 C.F.R. § 230.497(i)) and Article III, section 35 of the NASD Rules of Fair Practice, Nat'l Ass'n Sec. Dealers, Sec. Dealers Manual (CCH) ¶ 2195.

⁵⁸Two other communication formats utilized by investment companies deserve mention. "Generic" advertisements, which do not name any particular fund, have been permitted since 1972 as a way to promote the investment company industry generally. Sec. Act Rel. 5248 (adopting rule 135a under the Securities Act), *supra* note 44. 17 C.F.R. § 230.135a. In addition, funds distribute newsletters that often combine articles of general interest (non-offering material or "free writing") with separately designated rule 134 and rule 482 material. The Division has issued guidelines for the preparation of newsletters. See Letter from Kathryn B. McGrath, Director, Division of Investment Management, Securities and Exchange Commission, to Matthew P. Fink, Senior Vice President and General Counsel, Investment Company Institute (Jan. 29, 1990).

In order to accomplish this, the Division recommends adding a new subsection (g) to section 10 of the Securities Act, expressly authorizing the Commission to permit investment companies to advertise using this new advertising prospectus.⁵⁹ The Division believes legislation is desirable because section 10, as currently written, does not expressly authorize a prospectus the substance of which is not contained in the statutory prospectus. As already discussed, section 10(b) requires that the information in a section 10(b) prospectus "omit in part or summarize information in the [statutory] prospectus." Thus, section 10(b) clearly authorizes rule 482 "omitting prospectuses" and rule 431 "summary prospectuses." Dropping rule 482's requirement that the prospectus contain only information the substance of which is contained in the statutory prospectus arguably is not authorized by section 10(b). Assuming section 10 is amended, the Commission would then adopt the investment company advertising prospectus by amending rule 482 or by adopting a new rule and rescinding rule 482.

Eliminating the "substance of" requirement will not diminish investor protection. As a general matter, the "substance of" requirement does not, in itself, prevent misleading statements. The release proposing rule 482 states that advertisements can convey the same "idea" as the section 10(a) prospectus without using the same words, and that advertising "techniques" can be used even though the techniques are not themselves included in the section 10(a) prospectus.⁶⁰ These practices leave a great deal of room for underwriters and broker-dealers to rephrase information in ways that undermine the utility of the "substance of" requirement.⁶¹

⁵⁹A draft of proposed subsection (g) appears in Appendix 9-A at the end of this chapter. Congress also would need to make a technical, or conforming, amendment to section 2(10)(a) to add the words "or subsection (g)" after the words "subsection (b)." **This** would make clear that communications made under new subsection (g), like communications under subsection (b), would not be excepted from the definition of "prospectus" in section 2(10)(a).

⁶⁰Advertising By Investment Companies, Securities Act Release No. 5833 (June 8, 1977), 42 FR 30379. Rule 482 was at that time designated as rule 434(d).

⁶¹Some would argue that the requirement is useful in that, in the course of its review of registration statements, the Commission may uncover certain information, such as an adviser's past performance record, that is included in a registration statement to meet the "substance of" requirement. The Division could then advise the registrant that such information would, in the Division's view, be misleading if used in advertisements to sell the fund. We believe that the "substance of" requirement is not necessary for this purpose. Rule 482 (or any successor rule contemplated herein) provides the opportunity for the Commission to address the misleading character of particular types of information without the "substance of" requirement. In addition, rule 156 provides guidance on certain types of representations made in sales literature (including all advertisements) that are most likely to be misleading for purposes of an investment company's compliance with the general antifraud provisions. 17 C.F.R. § 230.156.

In addition, issuers may clutter statutory prospectuses with unnecessary information so that their omitting prospectuses satisfy the "substance of" requirement. Thus, the requirement actually may operate to obfuscate other, more important information in the statutory prospectus and to dissuade investors from reading it.

Because the proposed investment company advertising prospectus would still be a "prospectus," issuers and sponsors would remain liable for false or misleading statements of material fact under section 12(2) of the Securities Act. Also, the new subsection (g) would provide for the same summary suspension procedure as in section 10(b) of the Securities Act, permitting the Commission to take prompt action to prevent the use or distribution of unlawful or deficient advertisements. In addition, investment companies would still be required to deliver a copy of the statutory prospectus prior to, or with, the earlier of the confirmation of the sale or the delivery of the security.

Finally, the Commission would retain its ability to regulate any aspect of advertising in the advertising prospectus, such as performance claims, which are susceptible to being misused. In rule 482, the Commission has standardized the manner in which fund performance may be advertised. The Commission may retain those standards, which have worked well, without change, or may strengthen them in view of the expanded advertising that the proposed advertising prospectus would permit.

The Division also recommends that when the Commission adopts the new investment company advertising prospectus rule, it rescind the provisions of rule 134 (the tombstone rule) that apply only to investment companies. The new investment company advertising prospectus would provide sufficient flexibility so that investment companies could discuss topics, such as economic conditions, that currently are discussed in tombstones, but generally not in statutory prospectuses. The information would then be subject to prospectus liability, instead of only antifraud liability, which would increase investor protection.

B. "Off-the-Page" Advertisements

The Division has concluded that the Securities Act and rule 482 currently create an unwarranted competitive disadvantage for direct-marketed funds. Direct-marketed funds must attract investor interest by complying with the requirements of a safe harbor rule such as rule 482. Investors who clip a rule 482 advertisement must complete a form requesting the statutory prospectus⁶²

⁶²See *infra* note 68 and accompanying text.

which is received days, or perhaps even weeks (depending on when the investor has time to complete the form), after the investor first becomes interested. Finally, either the customer or the fund must initiate further contact to close the sale. This process is expensive and time-consuming.

In contrast, investors that desire to purchase investment company shares from brokers based on oral communications need not request, or wait for, a statutory prospectus before buying; they only need to receive the statutory prospectus prior to, or with, the earlier of the confirmation of the sale or the delivery of the securities, both of which occur after the investor has made an investment decision.⁶³ Thus, Investor A may discuss various investment options at his broker's office or over the telephone and may actually purchase securities based on those discussions without receiving a prospectus until the confirmation of the sale. Investor B, who also may know what she wants to buy based on her own reading and research, but whose interest runs to a fund that is not sold by commissioned sales personnel, cannot make her purchase until she requests and receives the prospectus.⁶⁴ Investor B is unable to invest her money as quickly as Investor A.

The Division recommends amending rule 482, or adopting a new rule, to give investors the option of purchasing mutual fund shares directly from advertisements ("off-the page").⁶⁵ Off-the-page advertisements would be required to contain standardized, core information about the fund. Under an off-the-page system, an investor would be able to purchase securities by completing an application form included with the advertisement, and sending a check with the completed form. The statutory prospectus would be delivered with the confirmation of the sale, paralleling the current requirements that apply to sales entered into on the basis of oral, rather than written, communications. Of course, investors also would have the option of requesting the statutory prospectus before investing; every off-the-page advertisement would be required to contain a prospectus request box, just as the rule 482 advertisements do today.

Selling off-the-page would provide significant savings for direct-marketed funds, would increase competition, and would provide investors with a new source of important information about their investment alternatives. The Division believes an amendment to rule 482 (or adopting a new rule) providing specific

⁶³See *supra* text accompanying note 28.

⁶⁴See *infra* note 68 and accompanying text.

⁶⁵The Division does not anticipate recommending that closed-end funds be permitted to use the off-the-page option because they typically use a more traditional type of underwriting. See *supra* note 17. The Division recommends that the Commission request comment on whether other types of investment companies, such as UITs, should be able to sell off-the-page.

requirements for selling off-the-page could be accomplished without statutory amendment.

Under the Securities Act as originally passed, the statutory prospectus occupied an elevated status as the only sanctioned selling document. Not only was there an affirmative obligation to deliver the prospectus to investors, there was a prohibition on using most other forms of written communications. As discussed above, in 1954, the strictness of the Securities Act regarding prospectuses was relaxed somewhat by amendments to section 10(b), which authorized the Commission to adopt rules providing for a prospectus that omits in part or summarizes information in the statutory prospectus. The statutory prospectus no longer was the only document that could be used to make offers.

The legislative history of the 1954 amendments to the Securities Act indicates that Congress, in authorizing section 10(b) prospectuses, was primarily concerned with legalizing offers during the waiting (or "pre-effective") period, when offers cannot be accepted. The legislative history does not discuss the role of section 10(b) prospectuses during the *post*-effective period, the period during which investment companies most extensively offer their shares, probably because traditional corporate underwritings sell out rapidly after the registration statement becomes effective, based on indications of interest received during the waiting period. There is nothing in the legislative history, however, that would indicate that section 10(b) prospectuses cannot form the basis for sales after the registration statement has been declared effective, as long as the liability provisions of sections 12(2) and 17 attach and the statutory prospectus is sent to the investor prior to, or with, the earlier of the confirmation of the sale or the delivery of the security.⁶⁶

In adopting rules under section 10(b), such as the summary prospectus rule and rule 482, the Commission has stated its intent to provide additional means for disseminating information, but not to supplant the statutory prospectus as the primary selling document.⁶⁷ In effect, in the case of rule 482, this means that although offers based on rule 482 advertisements are legal, sales based on rule 482 advertisements cannot proceed directly. The rule contains several requirements preventing investment companies from using rule 482 advertisements to close a

⁶⁶See S. REP. NO. 1036, *supra* note 46, at 12; see also *Hearings on S. 2846 Before a Subcomm. of the Senate Comm. on Banking and Currency, 83d Cong., 2d Sess. 31-32 (1954) (statement of Ralph H. Demmler, Chairman, SEC, regarding summary prospectuses).*

⁶⁷Sec. Act Rel. 3722, *supra* note 43 (adopting summary prospectus rule); Sec. Act Rel. 6116, *supra* note 54, (adopting rule 434(d), later renumbered rule 482).

sale, the most important of which prohibits an application form from accompanying the advertisement.⁶⁸

The Division recognizes the Commission's historical concern that the statutory prospectus be the primary selling document for securities transactions. Nonetheless, we believe that permitting off-the-page sales would promote increased dissemination of information, which would benefit the investing public. Off-the-page advertisements would be required to contain the most critical information in the statutory prospectus (although, as discussed below, the Division does not recommend restricting these advertisements to information contained in the statutory prospectus). These shortened versions of the statutory prospectus probably would be widely circulated and could be used by investors for comparative purposes. Moreover, as long as off-the-page advertisements are considered section 10 prospectuses ~~or~~ purposes of liability under section 12(2), and rule 482 (or a successor rule) adequately addresses the presentation of performance and other information in the advertisements, issuers would not be tempted to use this medium for misleading statements.⁶⁹

In addition, there are convincing policy reasons favoring an off-the-page system for investment companies. Funds sold primarily by broker networks make full use of the treatment accorded oral communications under the Securities Act.⁷⁰ Direct-marketed funds, on the other hand, have access to potential

⁶⁸The application form, which contains shareholder account information, cannot be sent alone because it would be an illegal "prospectus" unless preceded or accompanied by the statutory prospectus. Rule 482 also contains requirements for a legend encouraging the investor to request and read the statutory prospectus before investing, as well as information on how to obtain a statutory prospectus.

⁶⁹The Division also recommends that the Commission explore in rulemaking proceedings whether off-the-page advertisements should be subject to pre-filing and clearance requirements. Such requirements could lessen the possibility of misleading advertisements and would allow the Commission to monitor the ~~use~~ of off-the-page advertisements.

We also believe that ~~use~~ of off-the-page advertisements should be limited to mass media advertisements and not extended to mailings and similar solicitations. Where a fund sponsor chooses to mail prospective investors written materials, we believe it should be required to include a statutory prospectus.

⁷⁰Brokers who offer orally, either in person or over the telephone, are permitted to deliver the section 10 prospectus after the investor has made an investment decision. This situation was addressed when the Commission began requiring the broad distribution by underwriters and brokers of preliminary prospectuses to investors. See rule 460 under the Securities Act (~~which~~ does not apply to sales of certain investment company securities) and rule 15c2-8 under the Exchange Act. 17 C.F.R. § 230.460; 17 C.F.R. § 240.15c2-8. Preliminary prospectuses are not, however, widely used for sales of mutual fund securities because mutual funds generally do not
(continued..)

investors only through the print and broadcast media. Because sales through those media cannot be accomplished directly, these funds are at a disadvantage in reaching potential customers.

For an off-the-page system to work, the advertisements must be short enough to be economically feasible and yet convey enough information for investors to evaluate the investment. The success of the British off-the-page system suggests this can be done. Rule 7.25 of the British Conduct of Business Rules requires that off-the-page advertisements contain up to eighteen items of information, along with certain statements, if applicable.⁷⁰ These items include information regarding the minimum amounts that can be invested, sales charges, reinvestment options, redemption procedures, investment objectives, expenses, fees, and performance. Although these requirements are quite extensive, and the advertisements can take up half of a page or more of advertising space, the size of the advertisements has not prevented their use in the British press.

The Division believes that it would be appropriate to develop an off-the-page rule along the lines of the British rule. There is a limited universe of facts that are central to an investment in a mutual fund, particularly given the degree of standardization of the industry imposed by the Investment Company Act. The Division would anticipate working with the industry and investors through the rulemaking process to develop the presentation of core information in off-the-page advertisements. A similar exercise resulted in the development of a "fee table" for mutual fund prospectuses, which has proven extremely useful to investors. Much about the options for presenting information would be learned through the rulemaking process.

Investor protection issues arising from the ability to sell off-the-page also could be addressed through the rulemaking process. For example, the Commission may wish to consider imposing a "seasoning" requirement so that only funds that have been registered for a certain period of time, *e.g.*, two or more years, could sell off-the-page. The Division also recommends that the rule continue to require the advertisements to carry legends regarding the availability of the prospectus, so that investors would be able to request the prospectus by clipping the advertisement or calling the fund, just as they do today. This

⁷⁰(...continued)

begin marketing ~~until~~ after the registration statement becomes effective, and, in any case, the vast majority of offers as well as sales occur in the post-effective period when preliminary prospectuses are not used (because statutory prospectuses are available).

⁷¹See Securities and Investments Board (United Kingdom), the Financial Services (Conduct of Business) Rules 1987, rule 7.25.

requirement gives investors the option to study the statutory prospectus before investing.

Another issue that would be appropriate to consider during the rulemaking process is whether, if off-the-page sales are permitted, investors should be allowed to rescind purchases within a specified period of time (*e.g.*, mailing time plus five days) in order to allow for an appropriate review of the statutory prospectus. Purchase monies could be required to be held in escrow and not invested until the close of the waiting period. Alternatively, a system could be developed by which the investor would assume the risk of any fluctuation in share prices during the waiting period, but any sales charge would be returned if the investor chose to rescind.⁷²

A further question for review is whether an off-the-page rule should permit information other than the required information and, if so, under what standards. If the rule permits other information, the Commission must determine whether that information should be limited to information included in the statutory prospectus. The Division would not now recommend that off-the-page advertising be so limited. We think the reasons for abandoning the "substance of" requirement for rule 482 (or any successor) advertising also apply to off-the-page advertising. Furthermore, the current multiplicity of rules governing investment company advertising creates unnecessary confusion and resulting costs.⁷³ If the "substance of" requirement were to apply to off-the-page advertisements, but not to investment company advertising prospectuses, the situation would become further confused.

Thus, the Division recommends that off-the-page selling be an option under rule 482 (or its successor) which, as expanded, would not be limited to information in the statutory prospectus. Alternatively, off-the-page could be limited initially to information that is required by rule to appear.

⁷²British rules do not require that an investor be able to rescind his purchase as long as that fact is disclosed, although British investment schemes may voluntarily provide for that privilege. The Division recommends a similar approach, but anticipates further study and comment.

⁷³The concern centers mainly on the current rules as they apply to newsletters. A single newsletter may contain so-called "free writing" articles, separately designated rule 134 material, and separately designated rule 482 material. The existing multiplicity problem would be partially solved by deleting the investment company provisions of rule 134 and returning investment company "tombstones" to a more traditional format. See *supra* Section III.A.

IV. Other Options Considered

A. Requiring Prior Delivery of Mutual Fund Prospectuses

The Division also considered whether statutory prospectuses for mutual funds should be required to be delivered to investors prior to sale. After considering the issue, the Division does not recommend an advance prospectus delivery requirement for mutual funds.

We recognize there are legitimate arguments in favor of such a requirement. Statutory prospectuses for mutual funds are uniquely available because mutual fund securities are virtually always for sale. The timetable of the offering and the method of distribution for mutual funds are completely different than those for traditional issuers. In the case of mutual funds, there is not the same urgency or need to minimize risks; underwriters and brokers are not "on the hook" for large blocks of securities that must be quickly distributed at the retail level because mutual fund securities are sold on a "best efforts" basis. The timing of the offering does not depend on "indications of interest" solicited during the waiting period. Finally, there is no reason to resort to the alternative disclosure tool of the preliminary prospectus because the great majority of offers, and all sales, occur after the effective date of the registration statement.

On the other hand, the prospectus is easily obtained by anyone requesting it. Indeed, investors who know what they want to buy may not appreciate having to wait until their brokers send them a statutory prospectus. With the thousands of funds currently available, brokers may not be able to keep adequate stocks of prospectuses on hand. If the broker had to take the extra step of obtaining the prospectus from the fund, the process of actually getting the investor's money invested could be slowed unnecessarily. In the absence of evidence that investors are dissatisfied with the current system, or are not adequately informed today, we believe the possible benefits to be derived from an advance prospectus delivery requirement do not justify the time delays, additional costs, and administrative burdens that would be imposed.⁷⁴

B. Eliminating Liability under Section 12(2)

Some have argued that investment company advertisements should not be subject to prospectus liability under section 12(2) of the Securities Act, and that

⁷⁴A prospectus delivery requirement prior to sale would increase costs to some degree because brokers would have to adopt new sales systems to keep track of when prospectuses are sent and when sales are made.

investment companies should be able to advertise any information that is truthful and not misleading, subject only to the general antifraud provisions of the securities laws.⁷⁵ Proponents of this view suggest it would level the playing field between direct-marketed, whose written communications are subject to section 5(b)(1), and broker-sold funds, whose brokers' oral representations are not. This suggestion would do more than level the playing field, however, because oral representations are subject to section 12(2) liability for false statements. If the suggestion were implemented, that liability would no longer attach to written advertisements.

Proponents of this suggestion also argue that the antifraud provisions of the Securities Act and the Exchange Act are enough to protect investors. The Division strongly disagrees. Besides leaving investors without an express private right of action under the Securities Act,⁷⁶ the Commission would be left without a means to halt misleading advertisements under the summary suspension procedures authorized in section 10(b). The Division therefore recommends that the Commission not support legislation at this time that would expand investment company advertising in a way that would remove the protections of section 12(2).

V. Conclusion

The Division recommends amending the Securities Act so that investment companies may advertise a wide range of information in the form of a section 10 "investment company advertising prospectus," including information that is not included in the statutory prospectus required by section 10(a). If the Securities Act is amended to permit broader advertising subject to prospectus liability, we believe investment company tombstones should return to a traditional format similar to that of other issuers. We also recommend that mutual funds be permitted to sell "off-the-page" directly from an advertisement.

⁷⁵See, e.g., Letter from Dechert Price & Rhoads to Jonathan G. Katz, Secretary, SEC 54-56 (Oct. 10, 1990), File No. S7-11-90.

⁷⁶See *supra* notes 14-15 and 50-53, and accompanying text.

APPENDIX 9-A

Red-Lined Version of Proposed Amendment to the Securities Act of 1933

(new language is shaded; deleted language is struck through)

Section 10[15 U.S.C. § 77j].

* * *

(g) In addition to the prospectus permitted or required in subsections (a) and (b), the Commission may by rules or regulations deemed necessary or appropriate in the public interest or for the protection of investors permit the use of an advertising prospectus, for purposes of subsection (b)(1) of section 5, by an investment company registered under the Investment Company Act of 1940, or a business development company which is selling or proposing to sell its securities pursuant to a registration statement which has been filed under the Securities Act of 1933. The Commission may at any time issue an order preventing or suspending the use of a prospectus permitted under this subsection (g) pursuant to the procedures set forth in subsection (b) of this section.