



THE CHAIRMAN

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

April 16, 1993

CHAIRMAN'S OFFICE  
MAILED

APR 16 1993

The Honorable William S. Cohen  
Special Committee on Aging  
United States Senate  
Washington, DC 20510-6400

Signed by: \_\_\_\_\_

Re: Proposed Mutual Fund Prospectus Rule

Dear Senator Cohen:

Thank you for your letter of March 23, 1993, regarding the Commission's proposal to permit the use of simplified prospectuses by mutual funds (also referred to as "off-the-page" prospectuses). We appreciate having your comments on this proposal.

You indicate that your staff on the Senate Special Committee on Aging is conducting an investigation of alleged deceptive sales tactics by some mutual fund companies on small investors, particularly senior citizens. You are concerned that the Commission proposal may exacerbate the problem of small investors being duped into making inappropriate or risky investments. You also expressed concern that the new simplified offering materials would emphasize performance without adequate disclosure of the risks of investments.

The proposed simplified prospectus is intended to provide investors a concise presentation of information important to an investment decision. Investors would receive more detailed information about mutual funds than in current advertisements, and in a more condensed and readable format than in the full prospectus. The proposed rule would require prominent disclosure of the principal risks of investment, as well as a standardized presentation of performance data, and tabular disclosure of all fees and expenses. The proposal also would require simplified prospectuses to contain approximately twenty other items of information. With this information and format, investors not only would be better able to understand a particular investment option, but they also would be able to make comparative judgments about their investment alternatives, as these prospectuses are expected to be widely circulated. The level of detail required also should preclude the use of simplified prospectuses in connection with the kind of high pressured sales pitch that takes place in many telephone solicitations.

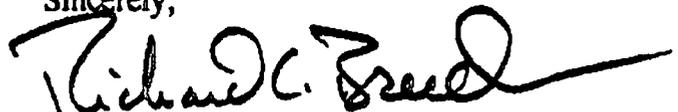
A number of safeguards are contained in the proposal. Simplified prospectuses, unlike many mutual fund advertisements, would have the legal status of prospectuses. Fund sponsors would have "prospectus liability," as well as antifraud liability, under the federal securities laws for false or misleading statements. Several layers of monitoring and review by Commission staff and the National Association of Securities Dealers, Inc. ("NASD") are also built into the proposal. For example, funds would prefile their proposed simplified prospectuses with the Commission or the NASD for the first year of their use, permitting advance review for misleading or exaggerated claims prior to circulation. To allow for ongoing Commission monitoring, every simplified prospectus also would be filed with the Commission within three days after it is first used. Investors could request the full prospectus before buying fund shares by checking a prominently displayed box. In all cases, a full prospectus would be delivered to all investors before, or with, the confirmation of

The Honorable William S. Cohen  
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sale. These and other safeguards are described more fully in the attached memorandum of the Commission's Division of Investment Management.

In your March 23 letter, you also requested a response to four specific questions about the simplified prospectus proposal. The enclosed memorandum contains more information about the proposal and responds specifically to your four questions. A copy of the proposal also is enclosed. If you require any additional information, please call Barbara Green, Deputy Director of the Division of Investment Management, at (202) 272-2045, or Matthew Chambers, Associate Director of the Division, at (202) 272-2039.

Sincerely,

A handwritten signature in black ink, appearing to read "Richard C. Breed", with a long horizontal flourish extending to the right.

Richard C. Breed  
Chairman

Enclosures

## MEMORANDUM

April 14, 1993

**To:** Chairman Breeden  
**From:** The Division of Investment Management  
**Subject:** Simplified Prospectuses

This memorandum responds to Senator Cohen's letter of March 23, 1993, regarding the Commission's proposal to allow mutual funds to use simplified prospectuses (also referred to as "off-the-page" prospectuses).

The Commission proposal would amend rule 482 under the Securities Act to permit certain advertisements for mutual fund shares to include an order form if they contain certain critical information. That information would be based on requirements for the full prospectus required by section 10(a) of the Securities Act of 1933 ("section 10(a) prospectus"). The simplified prospectus would state that the section 10(a) prospectus contains more information about the fund, however, and investors could request such a prospectus by checking a prominently displayed box. Investors who do not wish to review the section 10(a) prospectus prior to investing would still receive that prospectus before, or with, the confirmation of sale. Each fund would submit its proposed simplified prospectus for advance review by the National Association of Securities Dealers, Inc. ("NASD") or the Commission for a one year period beginning with the fund's first use of a simplified prospectus.

As you know, the Commission proposed to allow the use of simplified prospectuses because it believed that their use would promote increased dissemination of information about mutual funds. Simplified prospectuses would have a more condensed and readable format than section 10(a) prospectuses, and would provide significantly more specific information than existing mutual fund advertisements. Because the rule for the first time would require the inclusion of core information in mutual fund advertisements, simplified prospectuses should provide an additional, widely circulated source of important information that investors could use to make comparative judgments about their investment alternatives. Moreover, because simplified prospectuses are prospectuses under the Securities Act, mutual fund sponsors and sales representatives using simplified prospectuses would be subject to liability that should promote fair, complete, and accurate disclosure.

Our responses to Senator Cohen's four questions are set forth separately below.

**1. What is the timeframe for implementation of this rule?**

There is no specific timetable for implementing the rule. The public comment period closes on June 23, 1993. At that time, the Commission will assess the comments and determine whether or not to adopt a final rule. The length of this process will depend upon the nature and number of the comments received, but any final Commission action is unlikely to occur before late summer. The effective date of the final rule also may depend on whether the NASD must make any changes to its Rules of Fair Practice to implement procedures for review of simplified prospectuses. If the NASD must amend its rules, the simplified prospectus rule probably would not go into effect until those amendments are final; under section 19(b) of the Securities Exchange Act of 1934, there must be a period of

notice and comment before the Commission approves changes to the NASD's rules. This process could take several months.

2. **In developing this rule, how were issues concerning the protection of small, unsophisticated investors addressed? How does this rule affect investor protection mandates as outlined in the Investment Company Act of 1940?**

The proposed disclosure and format requirements address the concerns of small investors by requiring concise presentation of information that investors would find important to an investment decision. The rule would require simplified prospectuses to include twenty-one items of specific information about the fund, including the following: type of fund (e.g., money market fund); fees and expenses (in tabular form); standardized historical performance data; portfolio turnover rate; investment objectives and policies; principal risk factors; options for receiving dividends and distributions; tax consequences; purchase procedures; minimum initial and subsequent investment amounts; the purpose of asset based distribution fees, if any; restrictions upon redemptions; minimum account balances; and material pending legal proceedings. In addition, if the fund imposes front-end or back-end sales charges, the simplified prospectuses must also include a clear prominent statement of the consequences of those loads.

Such information would be presented in a concise, easily readable manner. Investors would not only be better able to understand a particular investment option but would also be able to make comparative judgements about their investment alternatives since these prospectuses are expected to be widely circulated.

Certain information that appears in the section 10(a) prospectus would not be required in a simplified prospectus. For example, the proposal would not require information about the responsibilities of the fund's board of directors; all the providers of administrative services; the name and address of the transfer agent and dividend paying agent; information about how to make shareholder inquiries; the name and address of the underwriter; an explanation of how the fund determines the public offering price; or complete details about special purchase plans or redemption procedures. Investors would receive that information in the section 10(a) prospectus, which they would receive no later than the confirmation of any purchase. Moreover, investors always could request the section 10(a) prospectus at any time: the proposal would require simplified prospectuses to contain a prominent legend stating that the section 10(a) prospectus is available free upon request and that investors who are not familiar with mutual funds may wish to obtain that prospectus before investing. The order form would be required to include a box investors could check to request the section 10(a) prospectus.

The proposal comes out of a report issued last year by the Commission's Division of Investment Management, *Protecting Investors: A Half Century of Investment Company Regulation*. In preparing the report, the Division met with a number of groups, including consumer groups. Many people expressed the concern that investors today do not read prospectuses. Representatives of one group told the Division that their members would be better served if the Commission could devise a short (1-2 pages) "plain English" prospectus. The proposed simplified prospectus would accomplish this objective and should benefit small, unsophisticated investors.

The proposed rule would not be available to certain investment companies with which small investors generally are not familiar or whose disclosure may be overly complex, such as closed-end companies and unit investment trusts. The exclusion of unit investment trusts means that the rule could not be used for periodic payment plans. In addition, only funds

that have been in existence at least two years from the first public sale of their shares would be eligible to use simplified prospectuses.

Thus, the simplified prospectus rule would fulfill the investor protection mandates outlined in the Investment Company Act of 1940. Section 1(b)(1) of the Investment Company Act articulates a policy that investors be able to purchase securities with "adequate, accurate, and explicit information, fairly presented, concerning the character of such securities and the circumstances, policies, and financial responsibility of such companies and their management." The Commission believes that this policy is satisfied by the extensive information requirements of the proposal, the requirement that any fund using the rule have been in operation for at least two years, the procedures for review by the Commission or the NASD, and the liability for misleading statements under various provisions of the securities laws (discussed below).

**3. What safeguards exist to prevent abuses resulting from overly simplistic marketing programs? How did the SEC take into account requests from State Securities Administrators that disclosure be enhanced in order to curtail the surge in sales practice abuses?**

The Federal securities laws contain several safeguards against misleadingly simplistic statements and thus should ensure fair and complete disclosure in simplified prospectuses. Simplified prospectuses, like other mutual fund advertisements complying with rule 482, would subject fund sponsors to "prospectus liability" for false or misleading statements of material fact under section 12(2) of the Securities Act. They also would carry liability for fraud under section 17(a) of the Securities Act and section 10(b) of the Securities Exchange Act, including rule 10b-5.

In addition, the proposal provides for several levels of review and monitoring to guard against misleading disclosure. First, simplified prospectuses would contain only information the substance of which is included in the fund's section 10(a) prospectus. Thus, the Commission staff would have had the opportunity to review the information in the course of reviewing the fund's registration statement (which includes the section 10(a) prospectus). Second, each fund would pre-file simplified prospectuses with the Commission or the NASD for a period ending one year after the fund's first use of any simplified prospectus. The NASD examiners already review many rule 482 advertisements to ensure, among other things, that they are not misleading or contain exaggerated claims. Finally, simplified prospectuses would be filed with the Commission no later than three days after the prospectus is first used, thereby permitting the Commission to monitor compliance with the rule.

It is unlikely that other, overly simplistic marketing materials would be mailed with simplified prospectuses. The Securities Act effectively would prevent the inclusion of most other sales literature in mailings with simplified prospectuses.<sup>1</sup> Thus, investors could not be lured into purchasing through simplified as a result of accompanying sales literature that provides misleading information about the fund.

The views of the North American Securities Administrators Association ("NASAA") received careful attention in the consideration of the proposal. In particular, NASAA expressed concern that important information might shrink and "drift" from simplified

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<sup>1</sup>The Securities Act of 1933 prohibits mailing such materials unless they are preceded or accompanied by a section 10(a) prospectus. Thus, they could not accompany or precede a simplified prospectus, unless a section 10(a) prospectus had already been sent.

U.S. Securities and Exchange Commission  
Washington, D.C. 20549

**FORM 482(G)**

*Mark one*

**FILING OF OFF-THE-PAGE PROSPECTUS FOR PRE-PUBLICATION REVIEW**

**OR**

**NOTICE OF USE OR PUBLICATION OF OFF-THE-PAGE PROSPECTUS**

Pursuant to Securities Act Rule 482(g) [17 CFR 230.482(g)]

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1. Investment Company Act File Number

811-

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2. Exact name of investment company as specified in registration statement:

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3. Address of principal executive office: (number, street, city, state, zip code)

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4. Date of Use or Publication of Off-the-Page Prospectus

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**INSTRUCTIONS**

1. This form must be attached to (A) a copy of a draft off-the-page prospectus that is submitted to the Commission for pre-publication review, or (B) a definitive copy of an off-the-page prospectus that is submitted after its first publication, in either case pursuant to rule 482(g).

2. Open-end companies whose principal underwriters are members of the National Association of Securities Dealers, Inc. (NASD) should file draft off-the-page prospectuses with the NASD for pre-publication review.

3. Five copies of submissions for pre-publication review must be filed at least twenty days before the draft off-the-page prospectus is to be submitted for publication.

4. Three copies of submissions for definitive copies shall be filed within three days after the first use or publication of an off-the-page prospectus.

5. Item 4 should be completed only for filings of definitive copies.

# CHAIRMAN'S CORRESPONDENCE

Date: \_\_\_\_\_

## INCOMING CORRESPONDENCE

Sender : Senator William Cohen

Affiliation : U.S. SEnate

Date : March 23, 1993

Drafted	<u>R.G. Bagnall</u>	<u>X3042</u>	<u>4/17/93</u>	<u>RCB</u>
	Full Name	Phone	Date	Initials

Approvals	<u>M.A. Chambers</u>	<u>X2039</u>	<u>MBC</u>	<u>4/13/93</u>
	<u>B. Green</u>	<u>X2045</u>	<u>BTG</u>	<u>4/13/93</u>
	_____	_____	_____	_____
	_____	_____	_____	_____

Consulting Divisions : \_\_\_\_\_  
\_\_\_\_\_

Chairman's Office Review : WTS 4.15.93  
Initials Date

Returned for changes: \_\_\_\_\_  
Date

Changes made: \_\_\_\_\_  
Name Phone Date Initials

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## United States Senate

SPECIAL COMMITTEE ON AGING  
WASHINGTON, DC 20510-6400

March 23, 1993

The Honorable Richard C. Breeden  
Chairman  
Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549

Dear Chairman Breeden:

I am writing regarding a new Securities and Exchange Commission proposal to simplify mutual fund purchasing procedures. It is my understanding that, over the next 90 days, this proposed rule is open for public comment. As the Ranking Member of the Senate Special Committee on Aging, I am concerned about the impact of this proposed rule on small investors, particularly senior citizens.

The current low interest rate environment is leading many savers to look for alternatives to interest-bearing instruments and accounts. As you know, many older Americans are now turning to mutual fund investments as an alternative to federally-insured certificates of deposits or money market accounts. A significant percentage of these individuals are small, unsophisticated investors with limited assets and an inability to bear significant losses.

For example, the Investment Company Institute estimates that more than a quarter of mutual fund investors are from households with less than \$25,000 in total pre-tax income and that 66 percent of mutual fund owners come from households with less than \$50,000 in pre-tax income. Evidence shows that many or even most of the current and prospective investors in mutual funds are largely unsophisticated consumers with limited awareness of the functioning of the marketplace. In general, their level of financial education is low in comparison to the multiplicity of products available and their lack of financial security renders them particularly vulnerable to misleading promises of high yields with low risks.

It is my understanding that the SEC proposal would, among other things, eliminate the current requirement that a mutual fund send a prospectus to all investors who respond to print advertisements or direct mailings. In an effort to streamline the sales process, advertisements and direct-mail solicitations would instead contain condensed versions of a prospectus. As you

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are aware, direct-mail solicitations are often heavily targeted at the elderly population. I have concerns that such advertisements or solicitations might overly emphasize performance without adequately disclosing the inherent risks of such investments to small investors.

My staff on the Aging Committee is conducting an investigation of alleged deceptive sales tactics by some mutual fund companies in which seniors are the prime victims of the alleged fraud. I have concerns that the proposed SEC rule may exacerbate the problem of small investors being duped into making inappropriate or risky investments, thus jeopardizing their life-time savings.

I would therefore appreciate it if you would respond to the following questions:

1. What is the timeframe for implementation of this rule?
2. In developing this rule, how were issues concerning the protection of small, unsophisticated investors addressed? How does this rule affect investor protection mandates as outlined in the Investment Company Act of 1940?
3. What safeguards exist to prevent abuses resulting from overly simplistic marketing programs? How did the SEC take into account requests from State Securities Administrators that disclosure be enhanced in order to curtail the surge in sales practice abuses?
4. Finally, in formulating the proposed rule, what considerations were made to ensure that inexperienced investors were fully aware and informed of the risks of investment and to secure protection for them from patently abusive or fraudulent offerings?

I would appreciate a response to these questions by Friday, April 16. Thank you very much for your attention and prompt reply to this matter. If you have any questions regarding this request, please have your staff contact Mary Berry Gerwin or Helen Albert of my Aging Committee staff at (202) 224-1467.

Sincerely,



William Cohen  
United States Senator

WSC:hma