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## THE COMPLEXITIES OF ON-LINE MUTUAL FUND ADVERTISING: A SUMMARY OF THE RELEVANT REGULATIONS

*As the investment marketplace advances with current technology, paper-based advertising has quickly been supplemented by on-line advertising. Interestingly, both the Securities Exchange Commission and the National Association of Securities Dealers are treating this new medium similarly to the old-fashioned paper-based medium. This iBrief discusses and summarizes the current regulations surrounding one emerging form of on-line advertising - that of mutual funds. This discussion is intended to form a solid foundation from which an interested party may delve further into this emerging area of e-commerce.*

### INTRODUCTION

¶ 1 In the year 2000, a "record-breaking 223 mutual funds bit the dust, victims of dwindling assets and lousy performance."<sup>1</sup> However, near and far across the American media landscape, from *Newsweek Magazine* to *CBS Sportsline.com*, mutual fund successes are prominently advertised. In some cases, these advertisements tout phenomenal performance statistics while, in others, they promise no-hassle financial security. However, in most cases, the required disclosures, warning potential investors of the risks inherent in these investments, are inconspicuously located at the bottom of the advertisement in diminutive font. This poses an obvious investor protection problem as today's ever emerging group of casual web-surfers part-time stock traders glance at mutual fund advertisements from one eye while analyzing NCAA Tournament brackets out of the other!<sup>2</sup>

¶ 2 On the other hand, mutual fund managers often claim that their ability to advertise is overly burdened by the federal securities laws. This sentiment stems from the fact that the Securities Act of 1933 (1933 Act) covers mutual fund advertising in its usual strict §5 manner and the National Association of Securities Dealers (NASD) has taken the lead among Self-Regulatory Organizations (SROs) in adding regulations to this area.<sup>3</sup> Although the Securities and Exchange Commission (SEC) promulgated safe-harbor provisions that often lessen these requirements, mutual funds, especially direct-marketed funds, still find their economic interests disadvantaged in the competition for investors' money. In fact, mutual funds,

entities continually issuing shares to the public, are expected to comply with statutory rules created specifically for entities periodically issuing securities to the public. These disadvantages often lead to calls for a more relaxed regulatory scheme to cover mutual fund advertising.

¶ 3 However, opponents of relaxed advertising standards argue that enough abuses exist under the current scheme and a looser standard would only make violations more prominent and more serious. In fact, the historical evidence demonstrates the SEC is continuously discovering, through its investigative processes, many "examples of false advertising and other misrepresentations to clients" - both in paper-based and in electronic advertisements.<sup>4</sup>

¶ 4 The discussion of these tensions between investor protection and marketing freedom has recently taken an interesting twist, as the investment marketplace quickly supplements printed advertising with on-line advertising. Mutual funds are developing their own niche in cyberspace, and today, most successful funds actively solicit interest via their own websites.<sup>5</sup> In fact, "mutual funds...are particularly well-suited to use the Internet [because] they continuously offer their shares to the public, and, in order to meet their obligations under the securities laws, must provide investors with a host of documents [a process far more cost effective on-line]...Moreover, mutual fund shares are generally owned by individual investors who...increasingly are using computers in their everyday life."<sup>6</sup>

¶ 5 The difficulty in summarizing the concepts of mutual fund advertising, however, lies not in the tensions described above. Rather, this difficulty lies primarily in the fact that "the regulation of mutual fund advertising is one of the most complex areas of the federal securities laws."<sup>7</sup> This complexity carries over from the detailed regulations promulgated, primarily by the SEC and by the NASD, for paper-based mutual fund advertisements. Thankfully, "the regulation of electronic advertising by mutual funds is no different [in its most important aspects] than the regulation of print advertising."<sup>8</sup> In fact, both the SEC and the NASD view the Internet as just another medium and continue to focus "primarily on the audience and content of the communication."<sup>9</sup> Therefore, the following summary of the regulations of mutual fund advertising is equally applicable to electronic and print advertising.

¶ 6 This iBrief will discuss and summarize the basic regulatory structure surrounding on-line mutual fund advertising. This discussion is intended to form a solid starting point from which an interested party can delve further into this emerging area of e-commerce. In fact, this short summary will be helpful because the regulation of mutual fund advertising is scattered haphazardly throughout the 1933 Act and the NASD rules.<sup>10</sup> This summary begins by detailing

the four most popular types of fund advertising allowed under the 1933 Act and the manner in which funds have advertised under each area. The second section discusses the NASD regulations concerning on-line advertising and the corresponding types of advertisements falling under each category. Overall, this summary organizes these regulations into a format, helpful to the practitioner and to the consumer, that both brings together these complicated regulations and sets up a platform from which the tensions between investor protection and marketing freedom may be addressed - perhaps in a future e-commerce iBrief!

## **THE 1933 ACT: TREATMENT OF ON-LINE MUTUAL FUND ADVERTISING**

¶ 7 The SEC regulates mutual fund advertising primarily through the 1933 Act and its restrictions on written communications offering securities to the public. In fact, mutual funds are subject to §5 of the 1933 Act when they offer<sup>11</sup> sell, or even advertise securities to the public - even through an electronic medium.<sup>12</sup> A mutual fund, operating under the grasp of §5, cannot advertise its securities to the public until it has filed a registration statement with the SEC.<sup>13</sup> In fact, a mutual fund can only advertise before its registration statement becomes effective if it employs a prospectus that meets the requirements of §10(a).<sup>14</sup> However, a mutual fund can advertise more freely after its registration statement becomes effective.<sup>15</sup> But, under all circumstances, mutual funds must deliver a statutory prospectus to the purchaser of its shares "no later than the delivery of the security or the confirmation of the sale, whichever occurs first."<sup>16</sup> This prospectus delivery requirement, coupled with the fact that most advertisements will be considered prospectuses with their corresponding content requirements, places a tremendous burden on mutual funds desiring to advertise their products. "

¶ 8 However, Congress and the SEC have recognized that funds have a legitimate interest in advertising their shares and that it is impractical to expect advertisements to include all of the information required in the statutory prospectus."<sup>17</sup> Therefore, a mutual fund has four different SEC-created advertisement options to market its shares and not have the advertisement considered a prospectus with its corresponding content requirements. These options are:

1. Generic Advertisements (Rule 135A);
2. Supplemental Sales Literature;
3. Tombstone Advertisements (Rule 134); and,
4. Omitting Prospectuses (Rule 482).

¶ 9 These four categories form the "basis of all mutual fund advertising."<sup>18</sup> In fact, commentators have noted, "an important part of the process of creating mutual fund advertising is finding a way to conform to these rules."<sup>19</sup>

### *GENERIC ADVERTISEMENTS*

¶ 10 First, under Rule 135a,<sup>20</sup> mutual funds can distribute generic advertisements to the on-line investing public.<sup>21</sup> These advertisements may "refer in general terms to securities as a method of investment but [must neither] refer to any specific security nor contain any performance information" [although the advertisement may include pictures or illustrations - as long as they are not misleading and conform to the rule requirements].<sup>22</sup> "Generic advertisements speak generally to the benefits of investing in mutual funds [and] may contain invitations to inquire for further information."<sup>23</sup> Ironically, while this rule does not allow the advertisement to identify a specific security, it does require that the advertisement identifies its sponsor - which "may provide a clue as to the identity of the fund."<sup>24</sup> These advertisements may be published and distributed by fund underwriters, broker-dealers, and sponsors of no-load funds, for example, and do not need to be accompanied or preceded by a statutory prospectus.<sup>25</sup>

¶ 11 An electronic generic mutual fund advertisement could, in theory, advertise any of the following information:

1. Explanatory information relating to fund shares, or to the services offered in connection with the ownership of those securities - Rule 135a(a)(1)(i).
2. Explanatory information relating to different types of funds, including their various investment objectives (such as balanced funds, growth funds, income funds, leveraged funds, specialty funds, variable annuities, bond funds, and no-load funds) - Rule 135a(1)(ii).<sup>26</sup>
3. Advertisements of other non-related, non-securities products - Rule 135a(1)(iii).
4. Requests for additional information inviting investors to contact the "advertisement's sponsor to request more complete or additional information...*If the advertisement encourages such inquiries and indicates that prospectuses for specific funds will be sent in response*, Rule 135a(b) requires the advertisement to specify the number of funds for which information will be provided, and, if applicable, to state that the sponsor of the advertisement is the principal underwriter or investment advisor of those funds" - Rule 135a(1)(iv).<sup>27</sup> These requirements are meant to alert the investor to a potential self-interest inherent in the generic advertisement.

## *SUPPLEMENTAL SALES LITERATURE*

¶ 12 Second, a fund can distribute electronic supplemental sales literature.<sup>28</sup> The only restriction for these advertisements is that this information must be accompanied or preceded by a statutory prospectus.<sup>29</sup> The SEC staff holds the view that "the prospectus delivery requirement implies that the prospectus will be delivered in a manner reasonably assured to make the intended recipient conscious of the fact that he or she has received a statutory prospectus."<sup>30</sup>

¶ 13 Some mutual fund websites are created following this exception to the statutory prospectus requirement. If fund statutory prospectuses are contained on a website and are easily accessible, the website could be characterized as 'supplemental sales material' for the purposes of legal review of the sales material.<sup>31</sup> These types of sites provide greater flexibility to the fund's advertising campaign as the information need not contain the information contained in the statutory prospectus.

## *TOMBSTONE ADVERTISEMENTS*

¶ 14 Third, a fund can create an electronic "tombstone advertisement" under Rule 134.<sup>32</sup> In fact, Rule 134 does not prescribe any limits on the type of media in which tombstone advertisements may appear. These tombstones may incorporate almost any type of information<sup>33</sup> about the fund except for performance information, yet the absence of performance data greatly hinders their effectiveness as an advertising tool.<sup>34</sup> There is no requirement that these advertisements contain any of the substance of the statutory prospectus and they need not be accompanied or preceded by a statutory prospectus.<sup>35</sup> A tombstone advertisement is not required to include all the categories of information prescribed by Rule 134 and need not present this information in the same sequence as set forth in the rule. The rule generally limits tombstone advertisements to information that has little risk of being misleading<sup>36</sup> or of causing tombstone advertisements to become selling vehicles for fund shares.<sup>37</sup> In fact, tombstone advertisements are not as heavily regulated as the supplemental sales literature or the Rule 482 advertisements, discussed *infra*, because they are excepted from the definition of prospectus in §2(a)(10).<sup>38</sup> From a liability standpoint, because Rule 134 advertisements are not prospectuses, only 10b-5 claims can realistically be brought against misleading tombstones.<sup>39</sup>

## *OMITTING PROSPECTUSES*

¶ 15 Finally, a mutual fund can advertise, without being considered a statutory prospectus, under Rule 482 - the "omitting prospectus" rule. This rule permits investment companies to advertise any information "the substance of which" is included in the statutory prospectus.<sup>40</sup> The essence of this rule is as follows: if the advertisement omits information from the statutory prospectus, all of the information in the advertisement must be derived from the statutory prospectus.<sup>41</sup> "A Rule 482 advertisement is not intended to replace the statutory prospectus, which must be delivered to an investor prior to or at the time of delivery of fund shares."<sup>42</sup> The most important aspect of this rule is that it allows funds to include standardized performance data in their advertisements.<sup>43</sup> From a liability standpoint, and unlike tombstone advertisements, §§ 12(1) and 12(2) extend private liability to violations of Rule 482 because these advertisements are considered prospectuses under the 1933 Act.<sup>44</sup>

¶ 16 Most of the current mutual fund websites are "Rule 482" sites and must comply with the requirements of Rule 482.<sup>45</sup> In the near future, these same "Rule 482" websites will not be limited to containing just the "substance of" the statutory prospectus. In fact, the National Securities Markets Improvements Act of 1996 (NSMIA) expressly permits the SEC to implement the use of an "advertising prospectus" to replace or, at the least, to serve as an alternative to, omitting prospectuses. An advertising prospectus would permit a mutual fund "to use a §10(b) summary prospectus that includes information the substance of which is not included in the statutory prospectus."<sup>46</sup> According to Congress, "this legislative change will help encourage more investor-friendly disclosure documents and increase the amount of timely information made available to investors."<sup>47</sup> The SEC staff has informally indicated that this rule will likely be promulgated in the near future, although Congress did not set any timetables for such promulgation.<sup>48</sup>

¶ 17 All of the above-mentioned SEC rules make it much easier for mutual funds to advertise on-line. In fact, although this legal framework "often seems arbitrary or artificial, remarkably, it has worked pretty well so far."<sup>49</sup> At this point, it is important to turn to the regulations of the SROs to summarize their governance of on-line mutual fund advertising. This iBrief deals solely with the NASD Conduct Rules because the NASD is the SRO that has taken the lead in regulating electronic mutual fund advertising and because "virtually all underwriters and / or distributors of fund shares are NASD members."<sup>50</sup>

## **NASD: TREATMENT OF ON-LINE MUTUAL FUND ADVERTISING**

¶ 18 The NASD is also an important player in the regulation of on-line mutual fund advertising as its Conduct Rules were recently amended to include electronic communications.<sup>51</sup> As with paper-based advertisements, the NASD rules similarly regulate electronic advertisements depending primarily on the advertisement's intended audience.<sup>52</sup> The NASD created four categories, under Conduct Rule 2210, under which electronic advertisements are regulated:

1. Advertisements - for communications to a broad audience;
2. Sales Literature - for communications to a targeted audience;
3. Correspondence - for communications to a single customer; and,
4. Communications in a live forum.<sup>53</sup>

¶ 19 All electronic advertisements falling under the Advertisements or Sales Literature categories must be approved, by signature or initial of a registered principal of the NASD member, prior to use or filing with the NASD.<sup>54</sup> Also, "a separate file of all advertisements and sales literature...shall be maintained for a period of three years from the date of each use."<sup>55</sup> Advertisements constituting Correspondence under the NASD rules are governed by a separate NASD Conduct Rule and are not as heavily regulated.<sup>56</sup> Advertisements fitting within the Communications in a live forum category are unregulated by the NASD. The following discussion centers on these definitions and the different types of electronic mutual fund advertising falling under each category.

#### *Communications to a Broad Audience*

¶ 20 This category is reserved for advertisements targeted toward a broad and anonymous audience. As stated above, the NASD defines these communications as "Advertisements" under Rule 2210(a)(1). Relevant examples might include: websites that are not password-protected, sites within a service providers' site, banner advertisements, stand-alone software programs, bulletin boards, and auditoriums run by the fund group.<sup>57</sup> Each "advertisement" must be filed and approved by a NASD official signature within ten days of first use.<sup>58</sup>

#### *Communications to a Targeted Audience*

¶ 21 This category includes electronic communications targeted to a known or restricted audience and it falls under the NASD's definition of "Sales Literature" under Rule

2210(a)(2). This category might include: group emails, password-protected websites accessible by the group, and research reports distributed to the customers, and published group messages.<sup>59</sup>

#### *Communication to a Single Customer*

¶ 22 The third category is reserved for an electronic communication that is prepared for a single customer and it falls under NASD definitions as "Correspondence" under Rule 2210(a)(3). This group might include: individual emails, password-protected areas of a website accessible by individuals (such as on-line trading and account balance areas), and published individual messages.<sup>60</sup>

#### *Communications in a Live Forum*

¶ 23 These situations, such as chat rooms, on-line auditoriums or webcasts, on-line interviews, Internet phone calls, and instant messages, are similar to a live conversation and do not fall under any of the above-mentioned NASD definitions.<sup>61</sup>

¶ 24 Most importantly, the NASD "has emphasized the supervisory and regulatory responsibilities of members when using the Internet and other electronic media" for advertising purposes.<sup>62</sup> These responsibilities require, for example, that NASD members "establish specific policies that address how and under what circumstances their associated persons are permitted to use electronic media to communicate with investors...[especially] where that communication medium allows the transmission of anonymous messages to chat rooms at bulletin boards."<sup>63</sup> Also, in late 1999, "the NASD proposed major changes to modernize, simplify, and clarify the rules governing mutual fund advertisements...Among other things, the proposals would exempt all institutional advertisements from pre-use approval and filing with the NASD, as well as form letters and group e-mails to existing customers and fewer than 25 prospective retail customers...These proposals would also exempt article reprints and certain press releases from filing."<sup>64</sup> These recent developments show the NASD's desire to allow its member funds more advertising freedom while also attempting to better protect investors through the filing and signature requirements.

¶ 25 Although these NASD rules are not as intimidating or complicated as the SEC rules, their importance in creating a valid mutual fund advertisement cannot be understated. In fact, both the SEC and the NASD have the power to force a mutual fund to discontinue an advertisement found violating their rules.



## CONCLUSION

¶ 26 Between the SEC and the NASD, on-line mutual fund advertising is encountering, and will continue to encounter, regulations similar to those promulgated for paper-based mutual fund advertising. This iBrief provides a concise summary of the relevant regulations and is intended to be used as a starting point for further research into this emerging area of the law.

¶ 27 This discussion becomes especially important as the mutual fund investment marketplace is quickly expanding into the arena of electronic advertising. The tensions, mentioned in the Introduction, between increasing investor protection and allowing greater advertising freedom are also present in this on-line marketplace and must be properly balanced in order deal fairly with all parties. As a beginning to this adaptation, the SEC is currently considering easing some of the current regulations, by allowing for advertising prospectuses - for example, in order to allow mutual funds to advertise more creatively and effectively. However, with this freedom comes the potential for reduced investor protection, a point previously illustrated by the fact the SEC is encountering the same investor protection problems with electronic advertising as it experienced with print advertising. Therefore, as on-line mutual fund advertising becomes even more prevalent, this discussion must push forward, and continue to consider the emerging issues on-line advertising creates, in an attempt to fairly balance these tensions.

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## Footnotes

1. Newsweek, March 12, 2001, at 77.

2. The fact that some of us part-time, on-line, investors were able to simultaneously choose Duke to win the NCAA championship while also scrutinizing these mutual fund advertisements is pure coincidence!

3. Matthew Bender, *Regulation of Investment Companies* §13.03 (2000). "As the primary regulators of mutual fund advertising, the SEC and the NASD have cooperated in carrying out their respective roles, with the SEC generally setting the policies [through releases and no-action letters] for mutual fund advertising and the NASD generally enforcing those

policies, although the NASD has also adopted policies of its own [through NASD Conduct Rules and in notices to its members on specific topics]."

4. *To Registered Investment Advisers, on Areas Reviewed and Violations Found during Inspections*, Letter from the Office of Compliance Inspections and Examinations <http://www.sec.gov/divisions/ocie/advltr.htm>, at 2. (visited March 3, 2001). *See also*, Lori Richards, *The New Internet Economy - A Compliance Imperative*, 1 (April 17, 2000).

5. Richards at 1.

6. Gavis, *The Offering and Distribution of Securities in Cyberspace: A Review of Regulatory and Industry Initiatives*, 52 Bus. Law. 317 (1996).

7. Bender, *supra* note 3, §13.01.

8. Bender, *supra* note 3, §17.06. In general, the SEC believes that mutual funds, delivering information electronically, can satisfy their obligations under the federal securities laws if such distribution results in the delivery to the intended recipients of substantially equivalent information as such recipients would have received if the required information were delivered to them in paper format. In the case of a fund prospectus, the SEC has confirmed that an on-line prospectus may use a different format of text than the paper version without the on-line version constituting a different version of the prospectus. The issue of timely and adequate notice and disclosure of electronic materials is beyond the scope of this iBrief.

9. Bender, *supra* note 3, §17.06.

10. Bender, *supra* note 3, §13.01. After the enactment of the National Securities Markets Improvements Act of 1996 (NSMIA) the states are no longer permitted to enact administrative requirements or standards, directly or indirectly, by which mutual fund advertising may be created or used. However, the NSMIA preserves the right of states to bring enforcement actions against investment companies with respect to fraud, deceit, or unlawful conduct in connection with securities or securities transactions. Pub. L. 104-296, 110 Stat. 3416 (1996).

11. 15 U.S.C. §77b(10) [The 1933 Act is hereinafter cited to the appropriate section as amended]. §2(3) defines offer very broadly as "every attempt or offer to dispose of, or solicitation of an offer to dispose of, or solicitation of an offer to buy, a security for value."

12. §5 of 1933 Act. *See also* Bender, *supra* note 3, §17.01.

13. §5(c) of the 1933 Act. Mutual funds file this registration statement with the SEC on Form N-1A. Closed-end investment companies file on Form N-2. The registration process proceeds in three stages: the pre-filing period, the waiting period [after filing and before effectiveness], and the effective period. All offers, other than those exempted from §5 - such as oral offers, are prohibited in the pre-filing period - this is referred to as "gun jumping" or "preconditioning the market."

14. §2(a)(10) of the 1933 Act states that a prospectus includes any advertisement or other communication written or by radio or television, which offers any security for sale. All prospectuses must comply with §10 requirements under §5(b)(1) of the 1933 Act. The SEC has also concluded in a no-action letter that this definition of prospectus includes a prospectus "encoded in electronic format." Brown & Wood, SEC No-Action Letter, 1995.

15. A registration statement basically becomes effective when the SEC says so.

16. §5(a) of the 1933 Act. A statutory prospectus contains the pertinent information contained in the registration statement that has been filed with the SEC. However, a statutory prospectus is a long document and cannot be effectively be part of a *Wall Street Journal* advertisement. Because of the safe harbor rules to be discussed below, however, these full statutory prospectuses do not have to take up 20 *Wall Street Journal* pages in order for a fund to be able to advertise.

17. Bender, *supra* note 3, §13.01.

18. *Id.*

19. *Id.*

20. All references to Rules in this paper refer to 1933 Act rules unless otherwise indicated.

21. The SEC adopted this rule under its general rulemaking authority under §19(a) of the 1933 Act. Rule 135a does not impose any specific limitations on the types of media in which a Rule 135a advertisement may appear.

22. Clifford E. Kirsch, *Mutual Fund and Variable Insurance Products Performance Advertising*, 50 Bus.Law. 92 (1995).

23. Bender, *supra* note 3, §15.01.

24. Kirsh, *supra* note 22, 12.

25. Bender, *supra* note 3, §15.02. A statutory prospectus is not required because a generic advertisement is not considered an "offer to sell" a security under §5 of the 1933 Act. Also, a generic advertisement is, therefore, not subject to prospectus liability under §11 and §12 of the 1933 Act, but it is still subject to the antifraud provisions under the federal securities laws.

26. Bender, *supra* note 3, §15.05.

27. *Id.* The SEC has recommended the following sample statement to comply with the disclosure requirements of this situation: "If you would like to know more about these mutual funds advised and distributed by X and Co., write to [name and address]."

28. Supplemental sales literature is not considered to be a prospectus under §2(a)(10) of the 1933 Act and thus is not subject to §5(b)(1) of the 1933 Act. However, supplemental sales literature may not be used prior to the effectiveness of a fund's registration statement.

29. §2(a)(10) of the 1933 Act exempts from the definition of prospectus a communication "preceded or accompanied" by a statutory prospectus. This is called supplemental sales literature because it supplements the statutory prospectus.

30. Bender, *supra* note 3, §18.02.

31. *Id.*

32. Bender, *supra* note 3, §14.05. Tombstone advertisements generally may be used anytime after a fund's 1933 Act registration statement has been filed with the SEC.

33. Tombstones can include information concerning a "company's investment objectives, policies, services, its methods of operations, the year of incorporation...and the aggregate net asset value as of the most practicable date." Clifford E. Kirsch, *Mutual Fund and Variable Insurance Products Performance Advertising*, 50 *Bus.Law.* 92, 11 (1995).

34. This conclusion is based on the idea that investors strongly rely on performance data when making their investment decisions. When performance data is not included in an

advertisement, common sense dictates that investor attention in the advertisement will decrease.

[35.](#) Bender, *supra* note 3, §14.06. Rule 134 sets forth specific categories of information that a tombstone advertisement for a fund may include. The inclusion of any other information will cause the advertisement to fall outside the rule's exception to the 1933 Act prospectus definition, thereby resulting in the advertisement being considered a prospectus.

[36.](#) Bender, *supra* note 3, §14.06. For this reason, information in advertisements based on Rule 134 must not relate directly to the desirability of owning or purchasing a security issued by a registered investment company. A persistent problem in tombstone advertisements, noted by the NASD, is a general inclination to use them as a promotional sales piece, rather than limiting them to descriptive pieces about the fund and an offer of the fund's prospectus.

[37.](#) *Id.*

[38.](#) Tombstones were excepted under the language of §2(a)(10) of the 1933 Act, which excepts from the definition of prospectus communications containing only specified information. This exception means that tombstone advertisements are not covered by §5 of the 1933 Act and its strong regulation of offers to sell.

[39.](#) Liability under §11 and §12(2) of the 1933 Act is likely not applicable because this information is not considered a prospectus. 10b-5 claims arise under the 1934 Securities Exchange Act under the liability provisions of §10.

[40.](#) *Advertising by Investment Companies*, SEC Release No. 6116 (Aug. 31, 1979), 44 FR 52816. §10(b) of the 1933 Act expressly authorizes the SEC to adopt rules and regulations permitting the use of a prospectus for the purposes of §5(b)(1) that "omits or summarizes" the information required to be in the §10(a) statutory prospectus. In fact, for purposes of §10(b) of the 1933 Act, a Rule 482 advertisement is a "prospectus" thereby satisfying the prospectus requirements of §5(b)(1).

[41.](#) *Protecting Investors: A Half-Century of Investment Company Regulation*, SEC Staff Report (CCH: 1992) at 360.

[42.](#) Bender, *supra* note 3, §16.05.

[43.](#) An analysis of the standardized fund performance advertisement requirements is beyond the scope of this iBrief.

[44.](#) In fact, this rule was adopted to allow funds to advertise performance data while still remaining subject to liability under §12 of the 1933 Act. §12(a)(1) liability attaches here because this section imposes liability on any person who offers or sells a security in violation of §5 and §5 generally requires that securities be sold pursuant to the statutory prospectus. §12(a)(2) liability is available here because a Rule 482 advertisement is a prospectus and §12(a)(2) of the 1933 Act applies to materially misleading prospectuses. Rule 482 advertisements would also be subject to the antifraud rules of the federal securities laws.

[45.](#) Bender, *supra* note 3, §17.06.

[46.](#) Bender, *supra* note 3, §16.20.

[47.](#) *Id.*

[48.](#) *Id.* In response to the adoption of the advertising prospectus, the SEC has stated that it would recommend rescission of the Rule 134 tombstone provisions applicable to mutual funds because the staff believes the new advertising prospectus would provide funds with sufficient flexibility to discuss topics currently permitted by rule 134.

[49.](#) Bender, *supra* note 3, §13.01.

[50.](#) Bender, *supra* note 3, §19.02. The NASD's authority over the offer and sale of fund shares arises from its responsibility to regulate the over-the-counter securities market.

[51.](#) Bender, *supra* note 3, Appendix H. The NASD, similarly to the SEC, applies the same rules to electronic communications as it does to paper based communications. The NASD has amended its definitions of "Advertisement" and "Sales Literature" under its Conduct Rules to include "electronic communications" and adopted a definition of "Correspondence" that includes any electronic communication prepared for delivery to a single current or prospective customer, and not for dissemination to the general public.

[52.](#) Bender, *supra* note 3, §17.06.

[53.](#) Bender, *supra* note 3, §19.02. Rule 2210 is entitled "Communications With the Public" and it sets forth the basic standards applicable to communications with the public and

applicable standards concerning the use and disclosure of NASD member names in communications. NASD member firms are required to submit their communications for NASD review and the NASD member is expected to comply with the subsequent comments it receives.

54. Rule 2210(b)(1). The member's legal department usually accomplishes this review.

55. Rule 2210(b)(2).

56. Reference Rule 3010 for the corresponding regulations regarding this recently amended category.

57. *Id.*

58. Bender, *supra* note 3, §20.02. In fact, for all of the following NASD communication categories, a member must file the sales material with the NASD Advertising Regulation Department within 10 days of first use or publication. However, NASD members that have been filing advertisements with the NASD for less than one year must file them 10 days in advance of first use. The member must provide with each filing that actual or anticipated date of first use. The NASD typically receives over 30,000 advertising and sales literature submissions per year.

59. *Id.*

60. *Id.*

61. *Id.*

62. Bender, *supra* note 3, §17.06. In fact, Rule 2210 requires that a NASD member (and its associated persons) adhere to high standards of commercial honor in dealing with members of the public.

63. *Id.*

64. *Id.* See also NASD conduct Rule 2210(a)-(e) and (f).