

## SECURITIES AND EXCHANGE COMMISSION

### 17 CFR Part 230

[Release Nos. 33-7399; IC-22529; File No. S7-18-96]

RIN 3235-AH03

### Proposed New Disclosure Option for Open-End Management Investment Companies

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Proposed rule.

**SUMMARY:** The Securities and Exchange Commission is proposing a new rule to permit open-end management investment companies to provide investors with a "fund profile." The profile would present a summary of key information about a fund, including the fund's investment strategies, risks, performance, and fees, in a concise, standardized format. A fund that provides a profile would be able to offer investors a choice of the amount of information they wish to consider before making an investment decision; investors would have the option of purchasing the fund's shares based on the information in the profile or requesting and reviewing the fund's prospectus (and other information). An investor deciding to purchase fund shares based on the information in a profile would receive the fund's prospectus with the confirmation of purchase.

**DATES:** Comments must be received on or before June 9, 1997.

**ADDRESSES:** Submit comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 5th Street, NW., Washington, DC 20549-6009. Comments can be submitted electronically at the following E-mail address: rule-comments@sec.gov. All comment letters should refer to File No. S7-18-96; include this file number on the subject line if E-mail is used. All comments received will be available for public inspection and copying in the Commission's Public Reference Room, 450 5th Street, NW., Washington, DC 20549-6009. Electronically-submitted comment letters will be posted on the Commission's Internet Web site (<http://www.sec.gov>).

**FOR FURTHER INFORMATION CONTACT:** David U. Thomas, Senior Counsel, Markian M.W. Melnyk, Senior Counsel, Kathleen K. Clarke, Special Counsel, or Elizabeth R. Krentzman, Assistant Director, (202) 942-0721, Office of Disclosure and Investment Adviser Regulation, Division of Investment

Management, Securities and Exchange Commission, 450 5th Street, NW., Mail Stop 10-2, Washington, DC 20549-6009.

**SUPPLEMENTARY INFORMATION:** The Securities and Exchange Commission (the "Commission") today is proposing for comment rule 498 (17 CFR 230.498) under the Securities Act of 1933 (15 U.S.C. 77a *et seq.*) ("Securities Act") and the Investment Company Act of 1940 (15 U.S.C. 80a-1 *et seq.*) ("Investment Company Act"). The new rule would permit an open-end management investment company that registers on Form N-1A (17 CFR 274.11A) (a "fund") to provide at its option a fund profile ("profile") to investors that contains a summary of key information about a fund. The Commission also is proposing amendments to rule 497 under the Securities Act (17 CFR 230.497) that would require a fund to file a profile with the Commission at least 30 days prior to its first use. In a companion release, the Commission is proposing revisions to the prospectus disclosure requirements in Form N-1A, the registration statement used by funds. These amendments seek to minimize prospectus disclosure about technical, legal, and operational matters that generally are common to all funds and to focus prospectus disclosure on essential information about a particular fund that would assist an investor in deciding whether to invest in that fund.<sup>1</sup> In another companion release, the Commission is proposing new rule 35d-1 under the Investment Company Act, which would, among other things, require a fund with a name suggesting that it focuses on a particular type of investment (e.g., an investment company that calls itself the ABC Stock Fund, the XYZ Bond Fund, or the QRS U.S. Government Fund) to invest at least 80% of its assets in the type of investment suggested by its name.<sup>2</sup>

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<sup>1</sup> Investment Company Act Release No. 22528 (Feb. 27, 1997) ("Form N-1A Release").

<sup>2</sup> Investment Company Act Release No. 22530 (Feb. 27, 1997) ("Fund Names Release"). Proposed rule 35d-1 would apply to all registered investment companies, including funds, closed-end investment companies, and unit investment trusts.

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#### I. Executive Summary and Introduction

Over the last decade, the fund industry has grown tremendously. With over 6,000 funds available and over 130 million shareholder accounts, fund assets exceed the deposits of commercial banks.<sup>3</sup> As more Americans turn to funds for professional management of current and retirement savings, funds have introduced new investment options and shareholder services to meet the needs of investors. While benefitting from these developments, investors also face an increasingly difficult task in choosing suitable fund investments. The Commission, fund investors, and others have recognized the need to improve fund disclosure to help investors evaluate and compare funds.<sup>4</sup> In the Commission's view, the growth of the fund industry and the diversity of fund investors warrant a new approach to fund disclosure that would offer more choices in the format and amount of information available about fund investments.

The Commission's commitment to improve the information provided in fund disclosure documents is longstanding, and the Commission has taken a number of steps to meet this goal.<sup>5</sup>

<sup>3</sup> See Investment Company Institute ("ICI"), *Trends in Mutual Fund Investing: November 1996* at 3 (Dec. 1996) (ICI News No. 96-107) ("ICI Trends") and ICI, *Memorandum on Supplementary Data* at 22 (Jan. 13, 1997) (as of November 1996, there were 6,243 funds and 148.5 million shareholder accounts); compare ICI Trends at 1 (fund net assets exceeded \$3.5 trillion as of November 1996) with 82 Fed. Res. Bull. 12, table 1.21, at A13 (1996) (commercial bank deposits were approximately \$2.5 trillion as of Sept. 1996).

<sup>4</sup> See, e.g., "From Security to Self-Reliance: American Investors in the 1990s," Remarks by Arthur Levitt, Chairman, SEC, before the ICI's General Membership Meeting, Wash., D.C. (May 22, 1996); Remarks by Steven M.H. Wallman, Commissioner, SEC, before the ICI's 1995 Investment Company Directors Conference and New Directors Workshop, Wash., D.C. (Sept. 22, 1995); "Toward Better Disclosure," Remarks by Isaac C. Hunt, Jr., Commissioner, SEC, before the American Society of Corporate Secretaries, Seattle, Wash. (June 26, 1996). See also McTague, *Simply Beautiful: Shorn of Legalese, Even Prospectuses Make Sense*, Barron's, Oct. 7, 1996, at F10 (concerning the recent efforts of the John Hancock funds and other fund groups to simplify their prospectuses).

<sup>5</sup> See Investment Company Act Release No. 20974 (Mar. 29, 1995) (60 FR 17172) (requesting comment on ways to improve risk disclosure and comparability of fund risk levels) ("Risk Concept Release"); Investment Company Act Release No. 21216 (July 19, 1995) (60 FR 38454) (proposing

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Today, the Commission is proposing new rule 498, which would permit a fund to provide investors with a profile. The profile would include a summary of key information about a fund, including a fund's investment objectives, strategies, risks, performance, fees, investment adviser and portfolio manager, purchase and redemption procedures, tax implications, and the services available to the fund's investors. The profile is designed to permit investors at their option to purchase a fund's shares based on the information in the profile or to request and review the fund's prospectus (and other information about the fund) before making an investment decision. Investors deciding to purchase fund shares based on a profile would receive the fund's prospectus with their purchase confirmation.

In connection with the profile initiative, the Commission also is proposing, in the first of two companion releases, changes to prospectus disclosure requirements ("Form N-1A Release"). This proposal seeks to focus prospectus disclosure on essential information about a particular fund that would assist an investor in deciding whether to invest in that fund.<sup>6</sup> In the other companion release, the Commission is proposing a new rule that would address investment company names. This rule would require funds and other registered investment companies with names suggesting a particular investment emphasis to invest at least 80% of their assets in the type of investment suggested by their names.<sup>7</sup> Taken together, the initiatives proposed today are intended to allow funds flexibility to respond to the diverse information needs of investors, improve and streamline prospectus disclosure, and address fund names that are likely to mislead investors about a fund's investments and risks.

In a related initiative, the Commission recently proposed rule amendments to

amendments designed to make money market fund prospectuses simpler and more informative); Investment Company Act Release No. 19382 (Apr. 6, 1993) (58 FR 19050) (simplifying financial highlights information and requiring management's discussion of fund performance); Investment Company Act Release No. 16245 (Feb. 2, 1988) (53 FR 3868) ("Fund Performance Release") (adopting a uniform formula for calculating fund performance); Investment Company Act Release No. 16244 (Feb. 1, 1988) (53 FR 3182) (adopting a uniform fee table in fund prospectuses). See also SEC, Report of the Advisory Committee on the Capital Formation and Regulatory Processes (July 24, 1996); SEC, Report of the Task Force on Disclosure Simplification (1996) (recommending specific improvements in the disclosure provided by corporate issuers).

<sup>6</sup> Form N-1A Release, *supra* note 1.

<sup>7</sup> Fund Names Release, *supra* note 2.

require the use of plain English principles in drafting prospectuses and to provide other guidance on improving the readability of prospectuses.<sup>8</sup> The Commission intends that the plain English initiatives serve as the standard for all disclosure documents, and the plain English proposals are an important counterpart of the proposed fund disclosure initiatives. If adopted, the plain English requirements would apply to fund prospectuses and the profile.

As part of a broad review of fund disclosure requirements, the Commission conducted a pilot program that permits funds to use profiles ("pilot profiles") with their prospectuses.<sup>9</sup> The Investment Company Institute ("ICI") and several large fund groups participated in the pilot program. The pilot profiles, like the profile proposed today, provide a summary of key information about a fund. The purpose of the pilot program was to assess whether investors found the pilot profiles helpful in making investment decisions. Focus groups conducted on the Commission's behalf ("Focus Groups") responded very positively to the profile concept, indicating that a profile would assist them in making investment decisions. Fund investors participating in a survey sponsored by the ICI strongly supported the pilot profiles.<sup>10</sup> In addition, many commenters, including individual investors, have endorsed the profile's goal of providing standardized, summary information about a fund.<sup>11</sup>

<sup>8</sup> Securities Act Release No. 7380 (Jan. 14, 1997) (62 FR 3152) ("Plain English Release"). In conjunction with these proposals, the Commission's Office of Investor Assistance has issued a draft of *A Plain English Handbook: How to Create Clear SEC Disclosure Documents* to explain the plain English principles of the proposed amendments and other techniques for preparing clear disclosure documents. See also "Plain English: A Work in Progress," Remarks by Isaac C. Hunt, Commissioner, SEC, before the First Annual Institute on Mergers and Acquisition: Corporate, Tax, Securities, and Related Aspects, Key Biscayne, Fla. (Feb. 6, 1997).

<sup>9</sup> See Investment Company Institute (pub. avail. July 31, 1995) ("1995 Profile Letter"). The Division of Investment Management has permitted the pilot program, with some modifications, to continue for another year. See Investment Company Institute (pub. avail. July 29, 1996) ("1996 Profile Letter").

<sup>10</sup> Letter from Paul Schott Stevens, Senior Vice President and General Counsel, ICI, to Barry P. Barbash, Director, Division of Investment Management, SEC, at 5-6 (May 20, 1996) ("ICI Survey Letter") (enclosing Investment Company Institute, *The Profile Prospectus: An Assessment by Mutual Fund Shareholders* (1996) (survey of over 1,000 fund investors)).

<sup>11</sup> A number of individual investors have written to the Commission expressing strong support for the profile. See also *Profile Prospectuses: An Idea Whose Time Has Come*, Mutual Funds Magazine, Aug. 1996, at 11.

Proposed rule 498 would implement the pilot program and give investors a new option of purchasing fund shares based on a profile, which would be a summary disclosure document. Each investor using the profile to make an investment decision would receive the full prospectus with the purchase confirmation. Since a fund's prospectus and other information about the fund would be available upon request, the profile would not reduce the information available to investors (or securities professionals). The profile also would not modify the protections afforded investors under the federal securities laws for misleading statements in fund disclosure documents. As an additional safeguard against misleading statements, rule 498 would require a fund to file the profile with the Commission before its first use, which would allow the Commission to monitor compliance with the profile disclosure requirements.

The profile would meet the Commission's goal of improving fund disclosure by providing:

- *A new disclosure choice for investors:* Focus Group participants and information from other sources indicate that different investors prefer different amounts of information before making an investment decision.<sup>12</sup> The profile would allow investors to choose the amount and format of information they want before making an investment decision. An investor comfortable with the level of information contained in a profile could purchase fund shares based on that information (and receive the fund's prospectus with the purchase confirmation). An investor who prefers more information before investing in a fund could use the profile to request the fund's prospectus and other information about the fund.

As a short, summary document, the profile could be a more efficient and less costly means of providing information to investors. A fund would have the flexibility to use diverse methods to distribute a profile (*e.g.*, by direct mail or by electronic media). To respond to investor interest, a fund could make the profile available and incur lower printing and mailing costs than it pays when sending a prospectus to every investor who is selecting among a number of similar or different types of funds. Investors, for example, could use the profile to narrow the number of funds being considered for investment and request prospectuses only for those funds about which the investor would

<sup>12</sup> See, *e.g.*, ICI Survey Letter, *supra* note 10, at 4-6.

like additional information before making a final investment decision.<sup>13</sup>

- *Standardized fund summaries:* Investors and others have expressed a strong preference for summary information about a fund in a standardized format.<sup>14</sup> The profile would meet this goal by requiring concise disclosure of 9 items of key information in a specific order and a question-and-answer format. These items would include a risk/return summary (also proposed to be required at the beginning of all fund prospectuses), which would summarize the fund's investment objectives, strategies, risks, performance, and fees.

Disclosure about a fund's risks would include a concise narrative description of the fund's overall risks and a bar chart that would illustrate graphically the fund's past risks by showing changes in the fund's returns from year to year. A table accompanying the bar chart would compare the average annual returns of the fund to those of a broad-based securities market index so that investors could evaluate the fund's performance and risks relative to the market.

Requiring profiles to present information in a standardized format should help investors identify key information about a fund and make comparisons among different funds. Rule 498 also would allow a fund to adapt the profile for use by investors in participant-directed defined contribution plans, who could use the summary information to evaluate and compare the investment alternatives offered by a plan.<sup>15</sup>

## II. Discussion

### A. General

The proposed requirements for the profile would be based on the current no-action letter of the Commission's Division of Investment Management ("Division") permitting the pilot profiles ("1996 Profile Letter").<sup>16</sup> Rule 498 would modify certain requirements in the 1996 Profile Letter in light of both the Commission's experience with the pilot program and its broad consideration of fund disclosure

requirements.<sup>17</sup> As in the pilot program, use of the profile would be limited to funds because the profile appears to be particularly well-suited to the structure and operation of funds and the way fund shares are marketed. Based on, among other things, the Commission's experience with the use of the profile by funds, the Commission may consider in the future extending rule 498 to other types of investment companies, including separate accounts and unit investment trusts.<sup>18</sup> The Commission requests comment whether and why the profile as proposed for funds would be appropriate for other types of investment companies.

Rule 498 would require 9 items of information to appear in a specific sequence and in a question-and-answer format. Standardizing the order of profile disclosure is designed to help investors locate information and compare the profiles of various funds.<sup>19</sup> The proposed question-and-answer format, frequently used by many funds, is intended to help communicate the required information effectively. The Commission is not proposing to limit funds to specific questions, and rule 498 would give funds the flexibility to substitute substantially similar questions to those included in the rule. The Commission requests comment on the proposed question-and-answer format and whether rule 498 instead should permit funds to choose the type of heading for the prescribed disclosure topics.

The profile would be a summary prospectus within the meaning of section 10(b) of the Securities Act.<sup>20</sup> As

a summary disclosure document, the profile is intended to provide a concise, standardized summary of key information disclosed in a fund's prospectus.<sup>21</sup> Rule 498 would identify the subjects to be covered and provide guidance about the degree of detail that is appropriate for a summary document. Rule 498 would require funds to include only the information specified by the rule.<sup>22</sup> The 9 items of required disclosure in the profile are intended to summarize key information in a fund's prospectus. As a result, a fund would not be able to use a profile when material information relating to its particular circumstances is not addressed by the instructions for the 9 items of required disclosure. The Commission believes that the goal of achieving a short, summary disclosure document that investors can use to evaluate and compare funds would not be met unless the rule establishes certain limits on the information included in a profile. The Commission requests comment on the types of disclosure proposed to be required in the 9 items and whether other or additional items would be appropriate.

The Commission's plain English proposal, which would modify the general rule under the Securities Act addressing prospectus disclosure,<sup>23</sup> would apply to the profile.<sup>24</sup> While the release proposing the plain English

6383 (Mar. 3, 1982) [47 FR 11380] (renumbering rule 434A as rule 431 [17 CFR 230.431]). Rule 498 is intended to replace the summary prospectuses that funds are permitted to use under rule 431, and the Commission is proposing to revise rule 431 to clarify that it is not applicable to funds. In keeping with this approach, the Commission is proposing to eliminate the "Instructions as to Summary Prospectuses" that accompany Form N-1A. See Form N-1A Release, *supra* note 1.

<sup>21</sup> The profile generally would provide a summary of the material elements in the prospectus, while the prospectus would provide a fuller description of each of these items. The prospectus, for example, would disclose the amount of any rule 12b-1 fees charged by a fund in the fee table and would include a narrative discussion about the fund's rule 12b-1 fees. In contrast, the profile as a summary disclosure document would disclose the amount of the fund's rule 12b-1 fees as part of the fee table disclosure. Similarly, a prospectus would identify each sub-adviser, if any, that manages a fund's portfolio while, in certain cases, a profile could disclose the number of sub-advisers managing the fund's portfolio without identifying each sub-adviser. See Form N-1A Release, *supra* note 1, and *infra* notes 58 and 65 and accompanying text.

<sup>22</sup> Proposed rule 498(b). In addition, a fund would not be allowed to use footnotes or to include cross-references within the profile or to other information, unless specifically required or permitted.

<sup>23</sup> Rule 421 under the Securities Act (17 CFR 230.421).

<sup>24</sup> In addition, an Instruction to rule 498 would advise a fund to present profile disclosure clearly and concisely, without using excessive details, legal or technical terms, complex language, or long sentences and paragraphs.

<sup>13</sup> Focus Group participants indicated that they would use the profile to narrow their investment options.

<sup>14</sup> Focus Group participants identified the standardized, summary fund information in the profile as particularly helpful in evaluating and comparing fund investments. See also ICI Survey Letter, *supra* note 10, at 4.

<sup>15</sup> See *infra* note 97 and accompanying text.

<sup>16</sup> 1996 Profile Letter, *supra* note 9. Any fund that has an effective registration statement and a current prospectus would be eligible to use a profile under rule 498.

<sup>17</sup> See Form N-1A Release, *supra* note 1. See also ICI Survey Letter, *supra* note 10.

<sup>18</sup> Currently, a profile of a fund that offers shares to a separate account registered on Forms N-4 (17 CFR 274.11c) or S-6 (17 CFR 239.16) must be accompanied by the separate account's prospectus. See National Association for Variable Annuities (pub. avail. June 4, 1996) (permitting variable annuity registrants to use "variable annuity profiles" together with their prospectuses).

<sup>19</sup> The profile would be subject to the font size and other legibility requirements for prospectuses under rule 420 of the Securities Act (17 CFR 230.420), which requires prospectuses to be in roman type at least as large and as legible as 10-point modern type.

<sup>20</sup> 15 U.S.C. 77j(b). See also section 24(g) of the Investment Company Act, 15 U.S.C. 80a-24(g). The Commission has long encouraged summary prospectuses under section 10(b) to supply investors with a condensed statement of the more important information included in the prospectus. In 1956, the Commission adopted a rule permitting the use of a summary prospectus under section 10(b), which was extended to investment companies in 1972. See Securities Act Release No. 3722 (Nov. 23, 1956) (adopting rule 434A (17 CFR 230.434A) to permit the use of a summary prospectus); Securities Act Release No. 5248 (May 9, 1972) (37 FR 10071) (extending rule 434A to investment companies); Securities Act Release No.

amendments was issued before this release and does not refer specifically to the profile, the Commission intends that the plain English requirements apply to all disclosure in the profile. If the proposed profile and the plain English requirements are adopted, the Commission intends to apply the plain English requirements specifically to the profile.

Under rule 498, a profile could describe more than one fund. The pilot profile, in contrast, contains information about a single fund.<sup>25</sup> The Commission's assessment of the pilot program and the Focus Groups conducted on the Commission's behalf indicate that a profile that describes more than one fund can achieve the goal of providing a summary disclosure document that assists investors in evaluating and comparing funds.<sup>26</sup> In particular, describing more than one fund in a profile can be a useful means of providing investors with investment alternatives offered by a fund group. The Commission recognizes, however, that too much information could make the profile lengthy, complex, and difficult to understand. Therefore, the Commission requests comment whether the number of funds described in a profile should be limited to one fund or some other number of funds to assure clear and concise disclosure.

## B. Profile Disclosure

### 1. Cover Page

Rule 498 would require the cover page of the profile to include certain basic information about the fund and to disclose that the profile is a summary disclosure document.<sup>27</sup> The cover page would include the fund's name and, at a fund's option, could disclose the fund's investment objectives or the type of fund offered (e.g., that the fund is a growth fund or invests its assets in a particular country). The profile cover page also would identify the disclosure document as a "profile"<sup>28</sup> and include a legend explaining the profile's purpose. The profile legend is intended to make it clear that investors may obtain the

fund's prospectus and other information about the fund before making an investment decision. In keeping with this objective, rule 498 would require a fund to provide the following legend: This Profile summarizes key information about the Fund that is included in the Fund's prospectus. If you would like more information before you invest, you may obtain the Fund's prospectus and other information about the Fund at no cost by calling \_\_\_\_\_.<sup>29</sup>

The Commission requests comment on the substance and wording of this legend. As an alternative, the Commission requests comment whether the legend should state the following:

This Profile summarizes key information about the Fund that is included in the Fund's prospectus. The prospectus includes additional material information about the Fund that you may want to consider before you invest. You may obtain the Fund's prospectus and other information about the Fund at no cost by calling \_\_\_\_\_.

The Commission requests comment whether this statement would better inform an investor of the profile's nature as a summary document and the availability of a fuller description about the fund and its operations in the prospectus.

To assure that investors receive additional information promptly, rule 498 would require a fund to send the prospectus within 3 business days of a request. The Commission views compliance with this requirement as an essential component of the profile initiative and the goal of promoting effective communication of information about funds. The Commission's Office of Compliance Inspections and Examinations would examine a fund's compliance with the 3-day requirement and the Commission would bring an enforcement action in an appropriate case for failing to comply with the requirement.<sup>30</sup>

<sup>29</sup> See 1996 Profile Letter, *supra* note 9, at 1 (requiring a similar legend). A fund would be required to provide a toll-free or collect telephone number for investors to request the prospectus or other information. If applicable, a fund could indicate that the prospectus is available on its Internet site or by E-mail. When an application to purchase the fund's shares accompanies the profile, rule 498 would require the application to present with equal prominence the option to invest in the fund based on the information included in the profile or request the prospectus before making an investment decision. See *infra* text accompanying note 72. The profile disclosure about the fund's investment strategies also would inform investors about the availability of additional information in the fund's shareholder reports. See *infra* note 37 and accompanying text.

<sup>30</sup> Proposed rule 498(b). In addition to the 3-day mailing requirement for prospectuses, rule 498 would require a fund to send within 3 business days of a request its annual or semi-annual shareholder report and Statement of Additional Information ("SAI"). The Commission staff also

### 2. Risk/Return Summary

The first 4 items of the profile would be substantially identical to the disclosure required in the proposed risk/return summary at the beginning of fund prospectuses.<sup>31</sup> The Form N-1A Release discusses these disclosure requirements in detail and requests specific comment about certain requirements. Commenters, therefore, also should review the discussion of the risk/return summary in the Form N-1A Release.<sup>32</sup> The Commission expects that if the requirements for the risk/return summary change in response to comments or otherwise, conforming amendments would be made to both rule 498 and Form N-1A.

The proposed first 4 items in the profile would require disclosure in response to the following questions:

- What are the fund's goals?

To assist investors in identifying funds that meet their general investment needs, rule 498 would require a fund to disclose its investment objectives.<sup>33</sup> A fund, at its option, also could disclose the type of fund offered.

- What are the fund's main investment strategies?

Rule 498 would require a fund to summarize, based on the information provided in the fund's prospectus, how the fund intends to achieve its investment objectives. The summary would be required to identify the fund's principal investment strategies, including the particular type or types of securities in which the fund invests or will invest principally, and any policy of the fund to concentrate in an industry or group of industries.<sup>34</sup>

A fund also would be required to inform investors about the availability of additional information about the fund's investments in the fund's shareholder reports. Fund annual reports typically include management's discussion of fund performance ("MDFP"), which describes a fund's strategies that materially affected the fund's returns during the most recent

would examine a fund's compliance with this requirement and the Commission would bring an enforcement action in an appropriate case for failing to comply with this requirement.

<sup>31</sup> See Items 2 and 3 of proposed Form N-1A. See also General Instruction C.2.(a) of proposed Form N-1A.

<sup>32</sup> Form N-1A Release, *supra* note 1.

<sup>33</sup> Proposed rule 498 (incorporating Item 2(a) of proposed Form N-1A). In providing this disclosure, a fund could refer to its investment objectives as investment goals.

<sup>34</sup> The criteria for determining whether a particular strategy is a principal strategy and disclosure about concentration policies are discussed in the Form N-1A Release, *supra* note 1.

<sup>25</sup> 1995 Profile Letter, *supra* note 9, at 2.

<sup>26</sup> See General Instruction C of proposed Form N-1A, *supra* note 1, for guidance on disclosing information for more than one fund in the same prospectus.

<sup>27</sup> Proposed rule 498. The cover page also would include the date of the profile. See *infra* note 84 and accompanying text regarding the proposed dating requirements. If the profile is distributed electronically or as part of another document (e.g., when the profile is printed in a magazine), rule 498 would require cover page information to appear at the beginning of the profile.

<sup>28</sup> In identifying the document as a "profile," a fund would be instructed not to use the term "prospectus." Proposed rule 498(c)(1)(ii).

fiscal year.<sup>35</sup> The Division's review of and experience with MDFP disclosure indicate that the annual report may be a valuable resource for investors.<sup>36</sup> The proposed rule would require the section of the profile relating to a fund's investment strategies to contain disclosure to the following effect: Additional information about the fund's investments is available in the fund's annual and semi-annual reports to shareholders. In particular, the fund's annual report discusses the relevant market conditions and investment strategies used by the fund's adviser that materially affected the fund's performance during the last fiscal year. You may obtain these reports at no cost by calling

<sup>37</sup> This disclosure would be required to appear in the context of information about a fund's investments.<sup>38</sup> The Commission requests comment on this approach. For example, would it be more helpful to investors if the profile included under a separate caption an explanation of the various types of additional information available to investors (e.g., the fund's shareholder reports and SAI)?

- What are the main risks of investing in the fund?

**Narrative Disclosure.** Rule 498 would require a fund to summarize the principal risks of investing in the fund based on the risk disclosure provided in the fund's prospectus.<sup>39</sup> The risk section of the profile would provide an overview of the risks to which the fund's particular portfolio as a whole is expected to be subject and the circumstances reasonably likely to affect adversely the fund's net asset value and performance. The risk section also would include disclosure about the risk of losing money<sup>40</sup> and identify the types

of investors for whom the fund may be an appropriate or inappropriate investment (based on, for example, an investor's risk tolerance or time horizon). Information about whether the fund is appropriate for particular types of investors is designed to help investors evaluate and compare funds based on their investment objectives and individual circumstances.<sup>41</sup> A fund, at its option, also could discuss in the risk section the potential rewards of investing in the fund as long as the discussion provides a balanced presentation of the fund's risks and rewards.<sup>42</sup>

**Special Disclosure Requirements.** A money market fund and a fund advised by or sold through a bank would be required to disclose in the risk section of the profile that an investment in the fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. A tax-exempt money market fund that concentrates its investments in a particular state would be required to disclose that investing in the fund may be riskier than investing in other types of money market funds, since the fund may invest a significant portion of its assets in a single issuer.

Similar disclosure for these funds currently is required to appear on the cover page of their prospectuses.<sup>43</sup> Consistent with the proposed risk/return summary in the prospectus, rule 498 would require this disclosure to appear in the risk section of the profile. Since the disclosure relates directly to a fund's risks, it would appear to be more meaningful to investors when presented in the context of information about the fund's risks. The proposed approach also would help streamline the profile cover page and avoid repeating information on the cover page and in the risk section of the profile.

Rule 498 would require a fund to disclose in the risk section of the profile (if applicable) that it is non-diversified.<sup>44</sup> To help investors understand this disclosure, rule 498

would require a non-diversified fund to describe the effects of non-diversification (e.g., that, compared to diversified funds, the fund may invest a greater percentage of its assets in a particular issuer) and to summarize the risks of this practice.<sup>45</sup>

**Risk/Return Bar Chart and Table.** Rule 498 would require the risk section of the profile to include a bar chart showing a fund's calendar year returns and a table comparing the fund's average annual returns to those of a broad-based securities market index.<sup>46</sup> The proposed rule would require the bar chart and table to be included in the risk section of the profile under a subheading that refers to both risk and performance.<sup>47</sup> Over 75% of individual investors responding to a Commission release requesting comment about ways to improve risk disclosure favored a bar chart presentation of fund risks.<sup>48</sup> Focus Group participants found both the bar chart and a tabular presentation of fund performance (particularly when the table included return information for a broad-based securities market index) helpful in evaluating and comparing fund investments.

The bar chart would present a fund's returns for each of the last 10 calendar years and would illustrate graphically a fund's past risks by showing changes in the fund's returns over time.<sup>49</sup> The table would present the fund's average annual

<sup>45</sup> The 1996 Profile Letter, *supra* note , at 2, requires a fund to disclose without further explanation that it is non-diversified.

<sup>46</sup> Proposed rule 498 (incorporating Item 2(c) of proposed Form N-1A).

<sup>47</sup> The 1996 Profile Letter, *supra* note , at 2-3, requires the bar chart and table to appear under a caption relating to a fund's past performance. To help investors use the information in the bar chart and table, the proposed rule would require a fund to explain how the information illustrates the fund's risks and performance. Item 2 of proposed Form N-1A would provide the following example of this explanation: This information illustrates the fund's risks and performance by showing changes in the fund's performance from year to year and by showing how the fund's average annual returns for one, five, and ten years compare to those of a broad measure of market performance. A fund also would be required to disclose that how the fund has performed in the past is not necessarily an indication of how the fund will perform in the future.

<sup>48</sup> See Risk Concept Release, *supra* note .

<sup>49</sup> The proposed rule would require the bar chart of a fund in operation for fewer than 10 years to include annual returns for the life of the fund. In addition, a fund would be required to have at least one calendar year of returns before including the bar chart. A fund that includes a single bar in the bar chart or a fund that does not include the bar chart because the fund does not have annual returns for a full calendar year would be required to modify, as appropriate, the narrative explanation accompanying the bar chart and table (e.g., by stating that the information shows the fund's risks and performance by comparing the fund's performance to a broad measure of market performance). See Item 2 of proposed Form N-1A.

<sup>35</sup> See Item 5 of proposed Form N-1A.

<sup>36</sup> Commenters also have cited the annual report as a source of valuable information. See Voss Sanders, *Dear Shareholder*, Morningstar Mutual Funds, Apr. 26, 1996, at 1 (commenting on improved annual report disclosure).

<sup>37</sup> If applicable, a fund could indicate that its annual and semi-annual reports are available on its Internet site or by E-mail request. In addition, a fund that provides its MDFP in the prospectus or a money market fund (which is not required to prepare a MDFP) would omit the second sentence of this disclosure.

<sup>38</sup> The 1996 Profile Letter, *supra* note 9, at 1, contemplates that information about the availability of a fund's shareholder reports appear at the beginning of the profile.

<sup>39</sup> Proposed rule 498(c)(2)(iii) (incorporating Item 2(c) of proposed Form N-1A). See also Form N-1A Release, *supra* note 1 (regarding fund risk disclosure proposed to be required in the prospectus).

<sup>40</sup> In recognition of the relative safety of money market funds, a money market fund would be required to state that: Although the fund seeks to preserve the value of your investment at \$1.00 per share, it is possible to lose money by investing in the fund.

<sup>41</sup> The 1996 Profile Letter, *supra* note 9, at 2, requires information about the appropriateness of the fund for particular types of investors to be presented under a separate caption. Because this information is closely related to the risks of investing in a fund, rule 498 would integrate this disclosure into the discussion of a fund's risks.

<sup>42</sup> The 1996 Profile Letter, *supra* note 9, at 2, permits disclosure about the rewards of investing in a fund only if presented separately from disclosure about the fund's risks.

<sup>43</sup> See Item 1(a)(vi) and (vii) of Form N-1A; Letter to Registrants from Carolyn B. Lewis, Assistant Director, Division of Investment Management, SEC, at II.B (Feb. 25, 1994).

<sup>44</sup> See Investment Company Act section 5(b) (15 U.S.C. 80a-5(b)) (regarding diversified and non-diversified funds).

returns for the last one, five, and ten fiscal years (or for the life of the fund, if shorter) and would provide comparable return information for a broad-based securities market index.<sup>50</sup> Requiring comparative return information for a broad-based market index would provide investors with a basis for evaluating a fund's performance and risks relative to the market.<sup>51</sup> The proposed approach also would be consistent with the line graph presentation of fund performance required in MDFP disclosure. Rule 498 would permit a fund to include return information for other indexes, including a "peer group" index of comparable funds.

While the average annual return information for the fund in the table would reflect the payment of any sales loads charged by the fund, the return information in the bar chart would not reflect sales loads.<sup>52</sup> Sales loads can be accurately and fairly reflected in return information of the type contained in the table by deducting sales loads at the beginning (or end) of particular periods from a hypothetical initial fund investment. Reflecting sales loads in the bar chart, however, may be impracticable. In addition, reflecting the payment of sales loads may be less important in the bar chart than in the table, since the bar chart is intended primarily to depict fund risks graphically. A fund that charges sales loads would be required to disclose that sales loads are not reflected in the bar chart and that, if the loads were

included, returns would be less than those shown.<sup>53</sup>

Rule 498 would require a multiple class fund to include return information in the bar chart for only one class. Because the returns of each class differ only to the extent the classes do not have the same expenses, including return information in the bar chart for all classes appears to be unnecessary to illustrate the risks of investing in the fund.<sup>54</sup> Rule 498 would require the bar chart to reflect annual return information for the class offered in the profile that has returns for the longest period over the last 10 years. This approach is intended to provide the greatest amount of information about changes in the fund's returns.<sup>55</sup>

Rule 498 would require a fund to provide in the table its average annual returns and those of a broad-based securities market index as of the end of the most recent calendar quarter prior to the profile's first use. A fund would be required to update this information for each succeeding calendar quarter as soon as reasonably practicable following the completion of the quarter. To avoid having to reprint the profile, a fund would be permitted to update performance information by using, for example, a sticker or stamp reflecting the updated information.

- What are the fund's fees and expenses?

Consistent with current prospectus disclosure, the profile would include a fee table summarizing a fund's fees and expenses, including any sales loads charged in connection with an investment in the fund.<sup>56</sup> Fees and expenses directly affect a fund's performance and can be important elements of an investment decision for fund investors. The fee table is designed to help investors understand the costs of investing in a fund and compare those costs with the costs of other funds.<sup>57</sup>

<sup>53</sup> Similar disclosure would be required if a fund charges account fees.

<sup>54</sup> In addition, the table accompanying the bar chart would provide return information for each class offered in the profile.

<sup>55</sup> When two or more classes included in the profile have returns for at least 10 years or returns for the same period but fewer than 10 years, the fund would be required to provide annual returns for the class with the greatest net assets as of the end of the fund's most recent fiscal year. Focusing on the class with the greatest net assets is intended to provide returns in the bar chart for a "representative" class offered in the profile.

<sup>56</sup> Proposed rule 498 (incorporating Item 3 of proposed Form N-1A). See also Item 2(a) of Form N-1A.

<sup>57</sup> See Form N-1A Release, *supra* note (proposing amendments to improve fee table disclosure).

## Other Disclosure Requirements

Rule 498 would require the profile to include disclosure about additional key aspects of a fund investment in response to the following questions:

- Who are the fund's investment adviser and portfolio manager?

Rule 498 would require a fund to identify its investment adviser and the person or persons primarily responsible for the day-to-day management of the fund's portfolio ("portfolio manager").<sup>58</sup> Rule 498 also would require information about the length of time the portfolio manager has managed the fund and a summary of the portfolio manager's business experience for the last 5 years. Focus Group participants indicated that information about a fund's portfolio manager was important in evaluating and comparing fund investments.<sup>59</sup>

When several persons act together to manage a fund's portfolio, profile disclosure, like the portfolio manager disclosure required in fund prospectuses, would indicate that a committee has primary responsibility for the fund's portfolio management.<sup>60</sup> When 3 or more persons each manage a portion of the portfolio, rule 498 would permit a fund to identify the number of persons managing the portfolio without naming each manager, except that, if a portfolio manager manages 40% or more of the fund's portfolio, information about that manager would be required to be disclosed.<sup>61</sup> When portions of a fund's portfolio are managed by several persons, the fund's risks and returns generally are less dependent on the activities of a particular person. Focusing profile disclosure on the number of a fund's portfolio managers would inform investors about the shared responsibility for the fund's portfolio management without adding unnecessary length to the profile. In addition, requiring information about any portfolio manager who manages 40% or more of a fund's portfolio would assure that disclosure would be provided when a portfolio manager has

<sup>58</sup> Proposed rule 498. Consistent with Item 6(a)(2) of proposed Form N-1A, rule 498 would not require information about the portfolio manager of a money market fund or an index fund.

<sup>59</sup> See also ICI Survey Letter, *supra* note, at 9 (recommending that the profile include this information).

<sup>60</sup> See Instruction 3 to Item 6(a)(2) of proposed Form N-1A.

<sup>61</sup> The 1996 Profile Letter, *supra* note, at 3, permits a fund to disclose that 3 or more persons manage the fund's portfolio, without regard to the percentage of the portfolio managed by any one person.

<sup>50</sup> A money market fund would be required to include its 7-day yield in the table. A non-money market fund would be permitted to disclose its yield, and any fund (including a money market fund) would be permitted to disclose its tax-equivalent yield. When yield information is disclosed, a fund would be required to include a toll-free (or collect) telephone number that investors can use to obtain current yield information.

<sup>51</sup> See 1996 Profile Letter, *supra* note, at 3 (permitting a fund, at its option, to compare its returns to those of an appropriate broad-based securities market index).

<sup>52</sup> The annual returns in the bar chart would be calculated using the same method required by Item 9 of proposed Form N-1A to calculate annual returns in the financial highlights information included in fund prospectuses. As in the case of annual returns in the financial highlights information, the returns in the bar chart would not reflect sales loads or account fees. The average annual returns included in the table would be calculated using the same method required by Item 21 of proposed Form N-1A to calculate fund performance included in advertisements, which reflects the payment of sales loads and recurring shareholder account fees. See also Item 5 of proposed Form N-1A (requiring sales loads and recurring shareholder account fees to be reflected in the return information shown in the line graph in the MDFP).

significant responsibilities with respect to the fund's portfolio.

A fund would be required to identify a sub-adviser (if any) subject to two exceptions.<sup>62</sup> First, rule 498 would not require a fund to identify a sub-adviser whose sole responsibility for the fund is limited to routine cash management.<sup>63</sup> Responsibility for routine cash management generally is incidental to a fund's investment objectives and unlikely to affect the fund's overall portfolio management and risks.<sup>64</sup> Second, consistent with the proposed approach for portfolio manager disclosure, rule 498 would permit a fund with 3 or more sub-advisers, each of which manages a portion of the fund's portfolio to disclose the number of sub-advisers without giving the name of each sub-adviser, except that the identity of any sub-adviser that manages 40% or more of the fund's portfolio would be required to be disclosed.<sup>65</sup>

The Commission requests comment on the proposed approach when 3 or more portfolio managers or sub-advisers each manage a portion of a fund's portfolio. The Commission requests specific comment on the proposed exceptions for providing information about any portfolio manager and the identity of any sub-adviser that manages 40% or more of a fund's portfolio. In particular, the Commission requests comment whether a lower or higher percentage would be appropriate. The Commission also requests comment on alternatives that would simplify this disclosure while continuing to provide information about a portfolio manager or sub-adviser that has significant responsibilities for management of a fund's portfolio.

• How do I buy the fund's shares? How do I sell the fund's shares?

Rule 498 would require a fund to describe in the profile under two

<sup>62</sup> See section 2(a)(20) (15 U.S.C. 80a-2(a)(20)) (defining "investment adviser" to include a sub-adviser).

<sup>63</sup> In contrast, the 1996 Profile Letter, *supra* note 9, at 3, requires disclosure about a sub-adviser only if it manages a material portion of a fund's portfolio.

<sup>64</sup> Information about a fund's cash management practices generally would not be disclosed in the section of the profile that discusses the fund's main investment strategies. See Form N-1A Release, *supra* note (prospectus disclosure would focus on a fund's principal strategies, which generally would not include the fund's cash management practices).

<sup>65</sup> See 1996 Profile Letter, *supra* note , at 3 (permitting a fund to provide disclosure to the effect that 3 or more sub-advisers manage the fund's portfolio without regard to the percentage of the portfolio managed by any one sub-adviser). To further limit the scope of this exception, a sub-adviser solely responsible for managing a fund's cash positions would not be counted in determining whether 3 or more sub-advisers manage the fund's portfolio.

separate questions how to purchase and how to redeem the fund's shares.<sup>66</sup> The purchase section of the profile would include information on minimum investment requirements (e.g., initial and minimum account balances) and, when applicable, any breakpoints in or waivers of sales loads.<sup>67</sup>

Apart from the general requirement to provide summary information and concise disclosure, rule 498 would not limit the extent of purchase and redemption information included in a profile. Funds participating in the pilot program disclosed this information concisely when the profile accompanied the prospectus. When a profile is used without the prospectus, however, a fund may find it necessary to disclose more extensive information about purchase and redemption procedures and, in particular, sales load breakpoints and waivers.<sup>68</sup> Including detailed purchase, redemption, and sales load information in the profile would appear to be inconsistent with the profile's purpose as a summary disclosure document. For this reason, the Commission requests comment whether rule 498 should impose any restrictions on the disclosure of purchase and redemption information. Commenters favoring limiting this disclosure are asked to provide specific suggestions for requirements that would serve to limit the disclosure while providing information that would assist fund investors in making investment decisions. Should the rule, for example, require a fund to summarize sales load information by showing the highest and lowest sales load breakpoints?

• How are the fund's distributions made and taxed?

Rule 498 would require the profile to describe how frequently a fund intends to make distributions and what reinvestment options (if any) are available to investors. Rule 498 also would require a fund other than a tax-exempt fund to state, as applicable, that the fund intends to make distributions

<sup>66</sup> Proposed rule 498, (vii).

<sup>67</sup> To help investors understand the meaning of the term "sales load," proposed Form N-1A would require the fee table and narrative discussion of sales loads in the prospectus to refer to "sales fees (loads)." This approach also would apply to profile disclosure.

<sup>68</sup> Fund prospectuses, for example, often include detailed information about automatic investment programs, telephone and wire redemption requests, rights of accumulation and letters of intent that can be used to reduce sales loads, and sales load waivers for particular classes of investors and transactions. See also Form N-1A Release, *supra* note 1 (proposing to modify certain prospectus disclosure requirements to focus prospectus disclosure on the amount of the sales load charged in connection with a fund investment).

that may be taxed as ordinary income and capital gains.<sup>69</sup> A tax-exempt fund would be required to state that it intends to distribute tax-exempt income and to disclose, as applicable, that a portion of its distributions may be taxable.<sup>70</sup>

• What other services are available from the fund?

Rule 498 would require the profile to summarize or list the services available to the fund's investors (e.g., any exchange privileges or automated information services).<sup>71</sup> Funds increasingly offer a wide variety of shareholder services. Information about the services offered by a particular fund may be useful to investors and help investors compare the services offered by different funds.

#### Application to Purchase Shares

Rule 498 would permit a fund to include an application with the profile to purchase the fund's shares.<sup>72</sup> To make

<sup>69</sup> Proposed rule 498(c)(2)(iii). If a fund, as a result of its investment objectives or strategies, expects its distributions primarily to consist of ordinary income (or short-term capital gains that are taxed as ordinary income) or capital gains, the fund would be required to provide disclosure to that effect.

<sup>70</sup> Rule 498 would give a tax-exempt fund the option of providing specific disclosure about its taxable distributions or a general statement that a portion of its distributions may be taxable. A fund choosing to disclose specific information would be required to provide the disclosure required by Item 7(d)(2)(ii) of proposed Form N-1A (i.e., The fund would be required to state, as applicable, that: (1) the fund may invest a portion of its assets in securities that generate income that is not exempt from federal or state income tax; (2) income exempt from federal income tax may be subject to state and local income tax; (3) any capital gains distributed by the fund may be taxable; and (4) a portion of the tax-exempt income distributed by the fund may be treated as a tax preference item for purposes of determining whether the shareholder is subject to the federal alternative minimum tax).

<sup>71</sup> Proposed rule 498(c)(2)(ix). Some funds using pilot profiles disclosed services relating to the purchase and redemption of the fund's shares (e.g., telephone redemption procedures) in the purchase and redemption sections of the profile, while other funds disclosed this information in the section of the profile relating to the services offered by the fund. Rule 498 would continue to give a fund the flexibility to disclose, as appropriate, information about its services in the purchase, redemption, or fund services sections of the profile. To keep profile disclosure concise, rule 498 would not permit information discussed in the purchase and redemption sections to be repeated in the section relating to fund services.

<sup>72</sup> Proposed rule 498(c)(3). Rule 482 under the Securities Act (17 CFR 230.482) prohibits a fund from including an application to purchase the fund's shares in an advertisement. This prohibition was based on concerns that an application would be inconsistent with the purpose of rule 482, which was to provide certain information about a fund and a means of requesting a fund's prospectus. See Fund Performance Release, *supra* note 5. In 1993, the Commission proposed to amend rule 482 to permit advertisements containing significantly

it clear that investors may review the prospectus before investing, rule 498 would require the application to present with equal prominence the options of investing in the fund based on the information in the profile or requesting the fund's prospectus before making an investment decision.

#### Disclosure Safeguards

The federal securities laws specifically contemplate the use of a summary prospectus, such as the profile, for offering securities.<sup>73</sup> As a consequence, existing protections under the federal securities laws would apply to false or misleading statements in a profile. The general provisions of sections 12(a)(2) and 17(a) of the Securities Act, which impose civil and criminal liability upon any person who offers or sells securities based on false or misleading statements, would apply to a profile as a summary prospectus.<sup>74</sup> The anti-fraud provisions of section 10(b) of the Securities Exchange Act of 1934 and rule 10b-5 under that Act also would apply.<sup>75</sup> Section 10(b) of the Securities Act also authorizes the Commission to suspend the use of a

more information about a fund and a purchase application. Investment Company Act Release No. 19342 (Mar. 5, 1993) (58 FR 16141). Unlike the proposed amendments to rule 482, rule 498 would require a profile to present a summary of key information about a fund in a standardized format and is being proposed by the Commission in conjunction with proposed amendments to Form N-1A that are designed to improve the disclosure provided in fund prospectuses. In connection with proposed rule 498, the Commission is proposing to amend rule 482 to clarify that it would not apply to profiles.

<sup>73</sup> Section 10(b) of the Securities Act permits the use of a summary prospectus (which provides information the substance of which is included in the prospectus) to communicate information for purposes of an offer under section 5(b)(1) of the Securities Act (15 U.S.C. 77e(b)(1)). Section 5(b)(2) of the Securities Act (15 U.S.C. 77e(b)(2)) requires, as a condition of selling a security, the delivery to investors of a prospectus that meets the requirements of section 10(a) of the Securities Act (15 U.S.C. 77j(a)). To meet this requirement, rule 498 would require a fund to provide its section 10(a) prospectus in response to an investor's request or, as required by section 5(b)(2), to provide the prospectus prior to or with the purchase confirmation. Recent legislation added new section 24(g) to the Investment Company Act authorizing the Commission to adopt rules permitting a fund to use a summary prospectus that includes information the substance of which is not included in the prospectus. National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290 (1996), section 204 (amending section 24 to add new paragraph (g)).

<sup>74</sup> 15 U.S.C. 77l(a)(2); 15 U.S.C. 77q(a).

<sup>75</sup> 15 U.S.C. 78j(b); 17 CFR 240.10b-5. See also Fund Performance Release, *supra* note 5, at 3878 (for anti-fraud purposes, disclosure in a section 10(a) prospectus will not cure a false or misleading advertisement (or "omitting prospectus" under section 10(b) of the Securities Act) permitted under rule 482).

summary prospectus if it includes false or misleading statements.<sup>76</sup>

Rule 498 would not permit a profile to incorporate by reference the information included in the fund's prospectus or any other disclosure document filed with the Commission.<sup>77</sup> The profile is designed to summarize prospectus information in a self-contained format that would assist an investor in making an investment decision or in deciding to request additional information. Permitting a fund to incorporate by reference into the profile information included in the prospectus would mean that information in the prospectus would be considered to be part of the profile disclosure.<sup>78</sup> This result would not be consistent with the purpose of the profile, which is to offer investors the option to make an investment in a fund based solely on the information in the profile.

Although investors would be able to purchase a fund's shares based on the summary information contained in a profile, the prospectus would remain the primary disclosure document under the federal securities laws. To inform investors about the availability of the prospectus, the profile would be required to include a legend on the cover page stating that more information is available in the prospectus, and the application accompanying the profile would be required to give equal prominence to the options of requesting a prospectus or investing in the fund. A fund would be required to deliver its prospectus either in response to an

<sup>76</sup> This administrative remedy supplements the Commission's stop order authority under section 8 of the Securities Act (15 U.S.C. 77h). Section 10(b) of the Securities Act specifically excludes summary prospectuses from section 11 of the Securities Act (15 U.S.C. 77k), which imposes strict liability for misleading statements in a prospectus. Congress adopted this exception to encourage the use of summary prospectuses. The exception was justified on the basis that the Commission's review of summary prospectuses would disclose deficiencies that could be corrected, and that the section 10(a) prospectus has to be delivered at or before the time a buyer receives the securities. See I. L. Loss & J. Seligman, Securities Regulation 480 & n.214 (3d ed. 1989) (*citing* S. Rep. 1036, 83d Cong., 2d Sess. 17-18 (1954) and H.R. Rep. 1542, 83d Cong., 2d Sess. 26 (1954)). If a misleading statement is included in both the prospectus and a profile, section 11 would apply to the sale of the fund's securities. See *id.*

<sup>77</sup> Proposed rule 498(b). See General Instruction D to proposed Form N-1A (permitting the SAI to be incorporated by reference in the prospectus, and other documents filed with the Commission to be incorporated by reference in the SAI and other parts of the Form N-1A registration statement).

<sup>78</sup> See *White v. Melton*, 757 F. Supp. 267, 271 (S.D.N.Y. 1991). See also Investment Company Act Release No. 13436 (Aug. 12, 1983) (48 FR 37928, 37930).

investor's request or with the purchase confirmation.<sup>79</sup>

#### D. Filing Requirements

Rule 498 would require a fund to file the profile with the Commission at least 30 days before its first use.<sup>80</sup> The pre-use filing requirement would allow the Commission to monitor compliance with rule 498's disclosure requirements and reduce the possibility of misleading information in a profile.<sup>81</sup> Subsequently, a fund would have to file any profile containing substantive changes to a previously filed profile 30 days before use.<sup>82</sup> No filing would be required for a previously filed profile that is revised only to update return information. The Commission requests comment on the proposed filing requirements, including whether the pre-use filing period of 30 days should be shorter or longer.

Rule 498 would require the profile filed with the Commission to be dated approximately as of the date of its first use.<sup>83</sup> Rule 498 also would require a fund to add the date of the most recent performance information included in the profile.<sup>84</sup> This requirement would alert investors to the updated performance information in the profile, while assisting the Commission staff in responding to inquiries by identifying the date of the profile filed with the Commission.

The profile would be filed electronically on the Commission's electronic data gathering analysis and retrieval system ("EDGAR").<sup>85</sup> The availability of the profile on EDGAR

<sup>79</sup> See also *supra* note 30 and accompanying text (a fund would be required to send the prospectus within 3 business days of a request).

<sup>80</sup> Rule 498 would require a fund to file the profile under rule 497, which sets out general filing requirements for fund prospectuses. New paragraph (k) to rule 497 would include the profile filing requirements. If the profile is revised during the 30-day period, a fund would be required to file a definitive copy of the profile within 5 business days of its use so that the Commission has a filed copy that is the same as the profile given to investors.

<sup>81</sup> The Commission has determined that it is not necessary or appropriate in the public interest or for the protection of investors to require that the profile be filed as part of a registration statement. Filing the profile as part of a registration statement would impose unnecessary burdens, would restrict the flexible use of the profile, and would not add to the Commission's ability to monitor the disclosure in the profile.

<sup>82</sup> Non-substantive changes to a profile would not require a filing before use of the profile, although a copy would be required to be filed within 5 days of use.

<sup>83</sup> Proposed rule 498(c)(1)(iii).

<sup>84</sup> A profile, for example, showing January 1, 1998 as its date of first use could include a parenthetical below the January date indicating that the profile has been "updated as of March 31, 1998."

<sup>85</sup> Rule 101(a)(1)(i) of Regulation S-T (17 CFR 232.101(a)(1)(i)) requires prospectuses filed pursuant to the Securities Act to be submitted in electronic format.



would permit public access to fund information in profiles. Although EDGAR does not currently reproduce graphic images (such as the profile bar chart),<sup>86</sup> the EDGAR rules require a fair and accurate narrative description or tabular representation in the place of any omitted material.<sup>87</sup> To assist the Commission's review of the content, use, and effectiveness of the profile, including the bar chart, a fund would be required to file 2 copies of the profile in the primary form intended to be distributed to investors (e.g., paper or electronic media).<sup>88</sup> This requirement would expire 2 years after the effective date of rule 498 because the Commission expects that the format and use of the profile would become largely routine and standardized by that time, and the pre-use filing of the profile on EDGAR would be sufficient to monitor compliance with the profile disclosure requirements.

#### E. Dissemination of Profiles

Rapidly changing technology, particularly the electronic distribution of information, has enhanced investors' access to securities-related information. The Commission has recognized these developments by allowing funds (and other registrants) maximum flexibility in the choice and use of distribution media.<sup>89</sup> In keeping with this approach, rule 498 would not limit a fund's use of any particular medium for disseminating the profile. A profile could be made available through direct mail and mass print (e.g., magazines and newspapers), broadcast, and electronic media. Permitting broad dissemination of the profile would be consistent with and further the purposes for which the profile is designed—to provide information about a fund in a

standardized and readily accessible format.

As in the case of other disclosure documents, the general requirements of the federal securities laws would impose certain limitations on the distribution of a profile. The means of distributing the profile would be required to communicate the information in the profile effectively and to enable an investor to review the disclosed information.<sup>90</sup> Each version of a profile (e.g., electronic or paper) would be required to contain all of the information required by rule 498.<sup>91</sup> In addition, while the profile may be delivered without a prospectus, a profile accompanied by sales literature cannot be delivered without the prospectus.<sup>92</sup>

Electronic media, such as the Internet, may be particularly well-suited for the delivery of the profile to investors.<sup>93</sup> Including the profile together with the prospectus (and other information) at a fund's Internet site also may be a more efficient method for funds to disseminate disclosure documents. Electronic availability of both the profile and prospectus could mean that investors could easily invest in a fund and access the fund's prospectus for more information.<sup>94</sup> An investor's use of an electronic application in the profile would create a presumption of delivery of the prospectus if both the profile and

the prospectus are available at the same electronic site.<sup>95</sup> A fund that does not electronically disseminate the profile and prospectus together could not rely on this presumption and would be required to provide a copy of the prospectus with the purchase confirmation.

#### F. Defined Contribution Plans

Investors in participant-directed defined contribution plans ("plans") may find a profile helpful in evaluating and comparing the funds offered as investment alternatives in a plan.<sup>96</sup> Certain information required by rule 498, however, appears to be unnecessary for plan participants because of the way these plans are structured and regulated. The requirements of the Employee Retirement Income Security Act of 1974 and the Internal Revenue Code, and the terms of individual plans govern, among other things, participant investments and plan distributions (including the tax consequences of distributions).<sup>97</sup>

To enable a fund to use a profile that is tailored for use by plan participants, rule 498 would permit a profile to omit information relating to the purchase and

<sup>95</sup> Cf. Electronic Distribution Release, *supra* note 89, at 53465-66 (example (39)) ("If the fund can identify the application form as coming from the electronic system that contains both the application and the prospectus, electronic delivery of the prospectus can be inferred.")

<sup>96</sup> In 1995, the Division issued a no-action letter confirming that certain informational materials about a fund offered as an investment option in a plan could be treated as an omitting prospectus under rule 482 of the Securities Act. Fidelity Institutional Retirement Services Company, Inc. (pub. avail. Apr. 5, 1995). The informational materials, which were intended to be distributed to plan participants, disclosed only information included in the fund's prospectus (i.e., the fund's investment objectives, policies and risks, expenses, past performance, and distribution practices) and contained a legend informing participants of the availability of the fund's prospectus.

<sup>97</sup> See 29 U.S.C. 1104(c). The most prevalent type of defined contribution plan is the 401(k) plan (26 U.S.C. 401(k)), which allows an employee to defer receipt and taxation of a portion of his or her salary and permits an employer to match a percentage of the employee's contributions. A 401(k) plan typically provides for individual accounts and permits a participant to exercise control over the assets in his or her account. These plans often provide several investment options, frequently including one or more funds. See Investment Company Institute, *Mutual Fund Fact Book 87* (36th ed. 1996) (at the end of 1995, more than \$161 billion, or 31%, of 401(k) assets were invested in funds). Section 404(c) of the Employee Retirement Income Security Act of 1974 and related rule 404c-1 (29 CFR 2550.404c-1) exempt fiduciaries of a 401(k) plan from liability for investment losses if a plan participant exercises control over the assets in his or her account. A participant is deemed to "exercise control" if, among other things, the plan offers at least 3 investment alternatives and a participant is provided or has the opportunity to obtain sufficient information to make informed decisions about the plan's investment alternatives.

<sup>90</sup> Electronic Distribution Release, *supra* note 89, at 53460 & n.20. Some media, particularly broadcast media, may be inappropriate for disseminating the profile because they may not communicate the profile information effectively (e.g., the bar chart may not be effectively conveyed by a radio broadcast) or provide a meaningful opportunity for retaining the information (e.g., a short television commercial).

<sup>91</sup> Release 21946, *supra* note 89, at 24653. A document, whether delivered electronically or on paper, must contain all required information and, if the order of information has been specified, must present the information in substantially the prescribed order. Electronic Distribution Release, *supra* note 89, at 53460 n.20.

<sup>92</sup> See section 2(a)(10)(a) of the Securities Act (15 U.S.C. 77b(a)(10)(a)) (excluding sales literature from the definition of a "prospectus" (and from the filing requirements under the Securities Act) if a section 10(a) prospectus (but not a summary prospectus under section 10(b)) precedes or accompanies the sales literature).

<sup>93</sup> Electronic media include, for example, electronic bulletin boards, E-mail, facsimiles, Internet sites, audiotapes, and videotapes. Electronic Distribution Release, *supra* note 89, at 53458 n.9.

<sup>94</sup> A fund could provide a hyperlink to the prospectus from the profile. A hyperlink in a document (which, for example, may be an underlined word or phrase) permits a viewer to "jump" to another document (or part of the same document) with a mouse click. The words "investment strategies" in the profile, for example, could be set up as a hyperlink to the discussion of investment strategies in the prospectus. Using hyperlinks would promote the profile's role as a gateway for fund investors to obtain additional information in the prospectus and other documents.

<sup>86</sup> The Commission anticipates future modifications that would permit EDGAR to reflect graphic images in electronically filed documents.

<sup>87</sup> Rule 304(a) of Regulation S-T (17 CFR 232.304(a)). Immaterial differences between delivered and electronically filed documents, such as pagination, color, type size, or corporate logo, need not be described.

<sup>88</sup> Proposed rule 497(k)(5).

<sup>89</sup> See Investment Company Act Release No. 21399 (Oct. 6, 1995) (60 FR 53458, 53460 & n.20) ("Electronic Distribution Release") (providing guidance on the electronic delivery of documents, including prospectuses, shareholder reports, and proxies, under the Securities Act, the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*), and the Investment Company Act); Investment Company Act Release No. 21945 (May 9, 1996) (61 FR 24644) (addressing the use of electronic media by broker-dealers, transfer agents, and investment advisers); Investment Company Act Release No. 21946 (May 9, 1996) (61 FR 24652) ("Release 21946") (adopting technical amendments to rules premised on the delivery of paper documents).

sale of fund shares, fund distributions, and tax consequences.<sup>98</sup> In addition, since some fund services (*e.g.*, exchange privileges) may not apply to plan participants, rule 498 would permit a fund to omit this information. Rule 498 would permit a fund to include the plan's enrollment form in lieu of the application form because the plan effects purchases and sales of a fund's shares on behalf of plan participants.<sup>99</sup> The cover page of the profile would disclose, as required by rule 498, that a fund's prospectus and other disclosure documents are available upon request.<sup>100</sup> The Commission requests comment whether other information required by rule 498 may not be useful for plan participants and could be omitted when a profile is used in connection with a plan.

#### General Request for Comments

The Commission requests that any interested persons submit comments on proposed rule 498 and other proposed amendments that are the subject of this release, suggest additional changes (including changes to related rules and forms that the Commission is not proposing to amend), or submit comments on other matters that might affect the proposed changes. Commenters suggesting alternative approaches are encouraged to submit proposed rule or form text. For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 (5 U.S.C. 801 *et seq.*), the Commission also is requesting information regarding the potential impact of the proposed rule on the economy on an annual basis. Commenters should provide empirical data to support their views.

#### IV. Paperwork Reduction Act

Proposed rule 498 contains "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 *et seq.*), and the Commission has submitted the proposed rule to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The title for the collection of information is "Profiles for Open-End Management Investment

Companies." Responses to the collection of information will not be kept confidential. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.

Section 10(a) of the Securities Act describes the type of information required in a prospectus used to offer securities for sale under section 5(b)(1) of the Securities Act. Sections 10(b) of the Securities Act and 24(g) of the Investment Company Act permit the Commission to allow the use of a prospectus by a fund that omits or summarizes information required by section 10(a). The Commission is proposing the profile as a summary prospectus under this authority.

Under proposed rule 498, the profile would present a summary of key information about a fund, including the fund's investment strategies, risks, performance, and fees, in a concise, standardized format. Investors would have the option of purchasing a fund's shares based on information in the profile or reviewing the fund's prospectus (and other information) before investing.

Under rule 498, use of the profile is permissive, but the rule is mandatory for those funds that elect to use a profile. The Commission expects funds would not choose to prepare and use a profile for every investment portfolio ("portfolio") they offer. In addition, a prospectus, and if used, a profile, may offer the securities of several portfolios. If a fund chooses to use a profile, it would be filed before its first use. Subsequent filings may be necessary if there are significant changes to the profile.

The Commission estimates that there are approximately 180 *new* registration statements filed by funds annually and that approximately 300 investment portfolios are included in initial registrations. The Commission estimates that funds would elect to use a profile for approximately one-third of these portfolios and a profile would include information for approximately two portfolios. Based on these estimates, the preparation and filing of profiles under rule 498 for these funds would represent a total annual burden of 1,250 hours (50 profiles x 25 hours per profile). The Commission estimates that there are approximately 2,700 registered open-end investment companies that have *effective* registration statements on Form N-1A representing approximately 7,500 portfolios. The Commission estimates that these funds would elect to use a profile for approximately one-third of these portfolios and that a profile would

include approximately two portfolios. Based on these estimates, the total annual burden for preparing, filing, and updating a profile would be 12,500 hours (1,250 profiles x 10 hours per profile) for funds with effective registration statements. For these two categories of filers (*i.e.*, funds filing new registration statements and funds with effective registration statements), the total annual burden of preparing, filing, and updating profiles is 13,750 hours.

Under 44 U.S.C. 3506(c)(2)(B), the Commission solicits comment to: (i) evaluate whether the proposed collection of information is necessary for the proper performance of the Commission's function, including whether the information shall have practical utility; (ii) evaluate the accuracy of the Commission's estimate of the burden of the proposed collection of information; (iii) enhance the quality, utility, and clarity of the information to be collected; and (iv) minimize the burden of the collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Persons desiring to submit comments on the collection of information requirements should direct them to the OMB, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, D.C. 20503, and should also send a copy of their comments to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 5th St., NW., Mail Stop 6-9, Washington, DC 20549-6009, with a reference to S7-18-96. The OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication, so a comment to OMB is best assured of having its full effect if the OMB receives it within 30 days of publication.

#### Summary of Initial Regulatory Flexibility Analysis

The Commission has prepared an Initial Regulatory Flexibility Analysis ("Analysis") in accordance with 5 U.S.C. 603 regarding proposed rule 498. The Analysis explains that the proposal would permit a fund to provide prospective investors with a profile, which would be a summary prospectus under section 10(b) of the Securities Act and section 24(g) of the Investment Company Act. The Analysis explains that a profile would include a summary of key information about a fund and give investors the option of purchasing the fund's shares based on the information in the profile or requesting

<sup>98</sup> Proposed rule 498.

<sup>99</sup> The enrollment form would not be required to be filed with the Commission because the form would be the responsibility of the company offering the plan and prepared in accordance with the plan's requirements and applicable law.

<sup>100</sup> General Instruction C of proposed Form N-1A would include similar revisions to prospectus disclosure requirements to allow funds to omit certain information from prospectuses that are limited to use in the retirement plan market. Form N-1A Release, *supra* note 1.

the fund's prospectus before making an investment decision. The Analysis also explains that the profile is intended to provide a standardized summary of 9 items of information about a fund in a specific order and in a question-and-answer format designed to help investors evaluate and compare funds.

The Analysis discusses the impact of the proposed rule on small entities, which are defined, for the purposes of the Securities Act and Investment Company Act, as investment companies with net assets of \$50 million or less as of the end of the most recent fiscal year (17 CFR 230.157(b) and 270.0-10). The Commission estimates that there are approximately 620 small entity investment companies, and that approximately one-third (207) could choose to use proposed rule 498. As explained in more detail in the Analysis, the Commission estimates that the total hour burden on small entities to prepare, file, and update the profile annually would be approximately 2,420 hours. While the profile would include a summary of information about the fund included in the prospectus, the disclosure requirements for the profile and the prospectus are designed for different purposes. The Commission believes that there are no other duplicative, overlapping, or conflicting federal rules.

The Analysis explains that proposed rule 498 would not be significantly burdensome for small entities because use of the profile is optional and the profile is intended to be a standardized summary of information required to be disclosed in a fund's prospectus. In addition, some investors may use profiles instead of prospectuses to narrow their choices among funds, which would reduce printing and distribution costs. Lower printing and distribution costs could benefit small entities as much or more than large funds.

As stated in the Analysis, the Commission considered several alternatives to proposed rule 498, including, among others, establishing different compliance or reporting requirements for small entities or exempting them from all or part of the proposed rule. Because use of the profile would be optional, and the profile, if used, would contain the same disclosure that other funds are required to include in the profile, the Commission believes that the proposed rule would not impose additional burdens on small entities and separate treatment for small entities would be inconsistent with the protection of investors.

The Commission encourages the submission of comments on the Analysis, including specific comment on (i) the number of small entities that would be affected by the proposed rule and (ii) the discussion of the impact of the proposed rule on small entities. Comments will be considered in the preparation of the Final Regulatory Flexibility Analysis if the proposed rule is adopted. A copy of the Analysis may be obtained by contacting Markian M.W. Melnyk, Senior Counsel, Securities and Exchange Commission, 450 5th Street, NW., Mail Stop 10-2, Washington, DC. 20549-6009.

#### VI. Statutory Authority

The Commission is proposing rule 498 under sections 5, 7, 8, 10, and 19(a) of the Securities Act (15 U.S.C. 77e, 77g, 77h, 77j, and 77s(a)) and sections 8, 22, 24(g), 30, and 38 of the Investment Company Act (15 U.S.C. 80a-8, 80a-22, 80a-24(g), 80a-29, and 80a-37). The authority citations for the rule precede the text of the amendments.

#### VII. Text of Proposed Rule

##### List of Subjects in 17 CFR Part 230

Investment companies, Reporting and recordkeeping requirement, Securities.

For the reasons set out in the preamble, the Commission proposes to amend Chapter II, Title 17 of the Code of Federal Regulations as follows:

#### **PART 230—GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933**

1. The authority citation for part 230 continues to read in part as follows:

Authority: 15 U.S.C. 77b, 77f, 77g, 77h, 77j, 77s, 77sss, 78c, 77d, 78l, 78m, 78n, 78o, 78w, 78j(d), 79t, 80a-8, 80a-29, 80a-30, and 80a-37, unless otherwise noted.

2. Amend § 230.431 to revise the introductory text of paragraph (a) to read as follows:

##### **§ 230.431 Summary prospectuses.**

(a) A summary prospectus prepared and filed (except a summary prospectus filed by an open-end management investment company registered under the Investment Company Act of 1940) as part of a registration statement in accordance with this section shall be deemed to be a prospectus permitted under section 10(b) of the Act (15 U.S.C. 77j(b)) for the purposes of section 5(b)(1) of the Act (15 U.S.C. 77e(b)(1)) if the form used for registration of the securities to be offered provides for the use of a summary prospectus and the following conditions are met:

\* \* \* \* \*

3. Amend § 230.482 to revise the introductory text of paragraph (a) to read as follows:

##### **§ 230.482 Advertising by an investment company as satisfying requirements of section 10.**

(a) An advertisement shall be deemed to be a prospectus under section 10(b) of the Act (15 U.S.C. 77j(b)) for the purpose of section 5(b)(1) of the Act (15 U.S.C. 77e(b)(1)), unless the advertisement is a profile under § 230.498 or is excepted from the definition of prospectus by section 2(10) of the Act (15 U.S.C. 77b(10)) and related § 230.134, if:

\* \* \* \* \*

4. Amend § 230.497 to revise paragraph (a) and to add paragraph (k) to read as follows:

##### **§ 230.497 Filing of investment company prospectuses, number of copies.**

(a) Five copies of every form of prospectus sent or given to any person prior to the effective date of the registration statement that varies from the form or forms of prospectus included in the registration statement filed pursuant to § 230.402(a) shall be filed as part of the registration statement not later than the date that form of prospectus is first sent or given to any person, except that:

(1) An investment company advertisement under § 230.482 shall be filed under this paragraph (but not as part of the registration statement) unless filed under paragraph (i) of this section; and

(2) A profile under § 230.498 shall be filed in accordance with paragraph (k) of this section and not as part of the registration statement.

\* \* \* \* \*

(k)(1) A form of profile under § 230.498 shall not be used unless:

(i) The form of profile is filed with the Commission at least 30 days before the date it is first sent or given to any person. No additional filing is required during the 30-day period for changes (substantive or otherwise) to a form of profile filed under this paragraph if copies of the changes are submitted to the Commission under paragraph (k)(5) of this section.

(ii) A form of profile that has a substantive change from or an addition to the information in the last form of profile filed under paragraph (k)(1)(i) of this section or under this paragraph (except a profile that is changed to update quarterly return information) is filed with the Commission at least 30 days before the date it is sent or given to any person. No additional filing is required during the 30-day period for

changes (substantive or otherwise) to a form of profile filed under this paragraph if copies of the changes are submitted to the Commission under paragraph (k)(5) of this section.

(2) The form of profile filed under paragraph (k)(1)(ii) of this section can be used on the later of 30 days after the date of filing or, if the changes or additions reflect changes to a prospectus included in a post-effective amendment filed to update a registration statement under § 230.485, the date the post-effective amendment becomes effective.

(3) File with the Commission a definitive form of a profile that varies from the profile filed under paragraph (k)(1) of this section no later than the fifth business day after the date it is used.

(4) Any form of profile that does not contain substantive changes from or additions to a definitive profile that was filed under paragraph (k)(3) of this section does not need to be filed with the Commission before use if it is filed no later than the fifth business day after the date it is used. A form of profile in which the only changes are updated quarterly return information does not need to be filed with the Commission.

(5) Send two additional copies of a form of profile filed electronically under paragraph (k)(3) of this section to the Commission, in the primary form intended to be used for distribution to investors (e.g., paper, electronic media), by mail or other means reasonably calculated to result in receipt by the Commission, no later than the fifth business day after the date the profile is first sent or given to any person. Send copies to the following address: Assistant Director, Office of Disclosure and Review, Division of Investment Management, U.S. Securities and Exchange Commission, 450 5th St. NW., Mail Stop 10-2, Washington, DC 20549-6009. Note prominently that the submission is made under § 230.497(k)(5) of Regulation C. If the profile is distributed primarily on the Internet, supply, in lieu of copies, the electronic address ("URL") of the profile page(s) in an exhibit to the electronic filing under this paragraph (k). This additional filing requirement shall expire on March 10, 1999.

5. Add § 230.498 to read as follows:

**§ 230.498 Profiles for Certain Open-End Management Investment Companies.**

(a) *Definitions.* A *Fund* means an open-end management investment company, or any series of the company, that has or is included in an effective registration statement on Form N-1A (§§ 274.11A and 239.15A of this chapter) and that has a current

prospectus under section 10(a) of the Act (15 U.S.C. 77j(a)).

(2) A *Profile* means a prospectus that is authorized under section 10(b) of the Act (15 U.S.C. 77j(b)) and section 24(g) of the Investment Company Act (15 U.S.C. 80a-24(g)) for the purpose of section 5(b)(1) of the Act (15 U.S.C. 77e(b)(1)).

(b) *General profile requirements.* A Fund may provide a Profile to investors, which may contain an application that investors may use to purchase the Fund's shares, if:

(1) The Profile contains only the information required or permitted by paragraph (c) of this section and does not incorporate any information by reference to another document.

(2) The Fund responds within 3 business days to a request for its prospectus, annual or semi-annual report, or Statement of Additional Information by first-class mail or other means designed to assure equally prompt delivery.

*Instructions to paragraph (b).*

1. The Profile is intended to be a standardized summary of key information in the Fund's prospectus. Additional information is available in the prospectus and in the Fund's annual and semi-annual shareholder reports and Statement of Additional Information. Do not include cross-references to this (or other) additional information or use footnotes in the Profile, unless specifically required or permitted.

2. Provide clear and concise information in the Profile. Avoid excessive detail, technical or legal terms, complex language, and long sentences and paragraphs.

3. File the Profile with the Commission as required by § 230.497(k).

(c) *Specific profile requirements.* (1) Include on the cover page of the Profile or at the beginning of the Profile if the Profile is distributed electronically or as part of another document:

(i) The Fund's name and, at the Fund's option, the Fund's investment objectives or the type of fund offered or both;

(ii) A statement identifying the document as a "Profile," without using the term "prospectus";

(iii) The approximate date of the Profile's first use and, if applicable, the date of the most recent updated performance information included in the Profile;

(iv) The following legend:

This Profile summarizes key information about the Fund that is included in the Fund's prospectus. If you would like more information before you invest, you may obtain the Fund's prospectus and other information about the Fund at no cost by calling \_\_\_\_\_.

*Instruction to paragraph (c)(1)(iv).*

Provide a toll-free (or collect) telephone number that investors can use to obtain the prospectus or other information. If applicable, the Fund may indicate that the prospectus is available on its Internet site or by E-mail request.

(2) Provide the information required by paragraphs (c)(2) (i) through (ix) of this section in the order indicated and in the same or substantially similar question-and-answer format shown:

(i) *What are the Fund's goals?* Provide the information about the Fund's investment objectives under Item 2(a) of Form N-1A.

(ii) *What are the Fund's main investment strategies?* Provide the information about the Fund's principal investment strategies under Item 2(b) of Form N-1A.

(iii) *What are the main risks of investing in the Fund?* Provide the narrative disclosure, bar chart, and table under Item 2(c) of Form N-1A. Provide the Fund's average annual returns and, if applicable, yield as of the end of the most recent calendar quarter prior to the Profile's first use and update the information as of the end of each succeeding calendar quarter as soon as practicable after the completion of the quarter.

(iv) *What are the Fund's fees and expenses?* Include the fee table under Item 3 of Form N-1A.

(v) *Who are the Fund's investment adviser and portfolio manager?* (A) Identify the Fund's investment adviser and any sub-adviser, unless the sub-adviser's responsibility is limited to routine cash management. When 3 or more sub-advisers each manage a portion of the Fund's portfolio (other than cash positions), the Fund may disclose the number of sub-advisers managing the portfolio, without identifying each sub-adviser, except that the identity of any sub-adviser that manages 40% or more of the Fund's portfolio must be disclosed.

(B) Using the Instructions to Item 6(a)(2) of Form N-1A, state the name and length of service of the person or persons employed by or associated with the Fund's investment adviser (or the Fund) who are primarily responsible for the day-to-day management of the Fund's portfolio and summarize each person's business experience for the last 5 years. When 3 or more persons each manage a portion of the Fund's portfolio, the Fund may disclose the number of persons managing the portfolio, without identifying each person, except that the information required by this paragraph must be disclosed for any person that manages 40% or more of the Fund's portfolio.

(vi) *How do I buy the Fund's shares?* Provide information about how to purchase the Fund's shares, including any minimum investment requirements. If applicable, disclose any breakpoints in or waivers of sales loads (referring to sales loads as "sales fees (loads)").

(vii) *How do I sell the Fund's shares?* Provide information about how to redeem the Fund's shares.

(viii) *How are the Fund's distributions made and taxed?* Describe how frequently the Fund intends to make distributions and what reinvestment options (if any) are available to investors. State, as applicable, that the Fund intends to make distributions that may be taxed as ordinary income and capital gains or that the Fund intends to distribute tax-exempt income. If a Fund, as a result of its investment objectives or strategies, expects its distributions primarily to consist of ordinary income (or short-term capital gains that are taxed as ordinary income) or capital gains, provide disclosure to that effect. For a Fund that holds itself out as investing in securities generating tax-exempt income, provide, as applicable, the information required by Item 7(d)(2)(ii) of Form N-1A or a general statement to the effect that a portion of the Fund's distributions may be subject to tax.

(ix) *What other services are available from the Fund?* Summarize or list the services available to the Fund's shareholders (e.g., any exchange privileges or automated information services), unless otherwise disclosed in response to paragraphs (c)(2) (i) through (viii) of this section.

(3) The Profile may include an application that a prospective investor can use to purchase the Fund's shares if the application presents with equal prominence the option to invest in the Fund or request the Fund's prospectus.

(4) A Profile of a Fund available as an investment option for participants in a defined contribution plan that meets the requirements for qualification under the Internal Revenue Code of 1986 may omit the information required by paragraphs (c)(2) (vi) through (ix) of this section. In lieu of the application permitted by paragraph (c)(3) of this section, the Fund may include the plan's enrollment form, which does not have to be filed with the Commission.

By the Commission.

Dated: February 27, 1997.

Margaret H. McFarland,  
Deputy Secretary.

[FR Doc. 97-5376 Filed 3-7-97; 8:45 am]

BILLING CODE 8010-01-P

## 17 CFR Part 270

[Release No. IC-22530; File No. S7-11-97]

RIN 3235-AH11

### Investment Company Names

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

**SUMMARY:** The Securities and Exchange Commission is proposing a new rule under the Investment Company Act of 1940 that would require a registered investment company with a name suggesting that the company focuses on a particular type of investment (e.g., an investment company that calls itself the ABC Stock Fund, the XYZ Bond Fund, or the QRS U.S. Government Fund) to invest at least 80% of its assets in the type of investment suggested by its name. Under current positions of the Commission's Division of Investment Management, these investment companies generally must invest only 65% of their assets in the types of investments suggested by their names. The proposed rule also would address names that suggest an investment company focuses its investments in a particular country or geographic region, names that indicate a company's distributions are exempt from income tax, and names that suggest a company or its shares are guaranteed or approved by the U.S. government. The new rule is intended to address certain broad categories of investment company names that are likely to mislead investors about an investment company's investments and risks.

**DATES:** Comments must be received on or before June 9, 1997.

**ADDRESSES:** Comments should be submitted in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 5th Street, NW., Washington, DC. 20549-6009. Comments also may be submitted electronically at the following E-mail address: rule-comments@sec.gov. All comment letters should refer to File No. S7-11-97; this file number should be included on the subject line if E-mail is used. All comments received will be available for public inspection and copying in the Commission's Public Reference Room, 450 5th Street, NW., Washington, DC. 20549-6009. Electronically-submitted comment letters will be posted on the Commission's Internet site (<http://www.sec.gov>).

#### FOR FURTHER INFORMATION CONTACT:

David U. Thomas, Senior Counsel, or Elizabeth R. Krentzman, Assistant

Director, (202) 942-0721, Office of Disclosure and Investment Adviser Regulation, Division of Investment Management, Securities and Exchange Commission, 450 5th Street, NW., Mail Stop 10-2, Washington, DC. 20549-6009.

**SUPPLEMENTARY INFORMATION:** The Securities and Exchange Commission today is proposing for comment new rule 35d-1 (17 CFR 270.35d-1) under the Investment Company Act of 1940 (15 U.S.C. 80a-1 *et seq.*) (the "Investment Company Act"). The new rule would apply to all registered investment companies and would require an investment company with a name that suggests that the company focuses on a particular type of investment to invest at least 80% of its assets in the type of investment suggested by its name. In addition, the rule would apply an 80% investment requirement to investment companies with names that suggest the company focuses its investments in a particular country (e.g., the ABC Japan Fund) or geographic region (e.g., the ABC Latin America Fund) and investment companies with names that indicate the company's distributions are exempt from federal income tax (e.g., the XYZ Tax-Exempt Fund) or exempt from both federal and state income tax (e.g., the XYZ New York Tax-Exempt Fund). The rule also would prohibit an investment company from using a name that suggests that the company or its shares are guaranteed or approved by the U.S. government.

In separate companion releases, the Commission is proposing two initiatives designed to improve the disclosure provided to investors by open-end management investment companies ("funds"). First, the Commission is proposing significant amendments to the prospectus disclosure requirements of Form N-1A (17 CFR 274.11A), the registration statement used by funds.<sup>1</sup> These amendments seek to minimize prospectus disclosure about technical, legal, and operational matters that generally are common to all funds and to focus prospectus disclosure on essential information about a particular fund that would assist an investor in deciding whether to invest in that fund. Second, the Commission is proposing new rule 498 under the Securities Act of 1933 (15 U.S.C. 77a *et seq.*) and the Investment Company Act, which would permit an investor to buy a fund's shares based on a summary document, or "profile," that contains key

<sup>1</sup> Investment Company Act Release No. 22528 (Feb. 27, 1997) ("Form N-1A Release").