

Comment Letter on NASAA Advertising Proposal, May 1997

May 29, 1997

Ms. Leslie Scott
Assistant Secretary of State
Office of the Secretary
Securities Division
202 North Congress Street, Suite 601
Jackson, Mississippi 39201

Re: NASAA Proposed Statement of Policy Regarding Broker-Dealer Advertising

Dear Ms. Scott:

By letter dated August 28, 1996, the Investment Company Institute¹ wrote to you and the other members of NASAA's Sales Practices Committee to comment on the Committee's proposed Statement of Policy relating to broker-dealer advertising. In summary, our letter recommended that the proposal exclude investment company securities from its coverage and that any provisions governing investment company advertising and sales literature be incorporated instead into another proposed NASAA Statement of Policy, "Dishonest or Unethical Practices in Connection with Investment Company Securities." In response to the Institute's letter, the Committee recently has asked the Institute to provide specific comments on the advertising policy as proposed. This letter is in response to the Committee's recent request.

Impact of NSMIA on the Committee's Proposal

A review of the Committee's advertising proposal subsequent to the passage of the National Securities Markets Improvement Act of 1996 ("NSMIA") indicates that application of the proposal to "covered securities," including investment company securities, has been rendered moot. Accordingly, we rescind our previous recommendation to you and instead recommend that the Committee amend its proposal to expressly exclude its application to any investment company advertising or sales literature.

As you know, NSMIA prohibits any state from directly or indirectly prohibiting, limiting, or imposing any condition upon the use of any offering document or disclosure document relating to a covered security. The terms "offering document" and "disclosure document" as used in NSMIA would include those items defined in the Committee's proposal to be an "advertisement" or "sales literature" subject to the proposal's requirements. Under NSMIA, like prospectuses, advertising by investment companies is not a "sales practices" that the states have any authority to regulate. To the extent that NSMIA preserves the right of states to bring enforcement actions against broker-dealers with respect to "fraud or deceit" or "unlawful conduct" in connection with securities or securities transactions, that does not include any grant of authority to the states to enact administrative standards by which mutual fund advertisements may be created or used.² We find it inconceivable that, under the proposed NASAA standards, a state securities administrator would find something "fraudulent" or "deceitful" in an advertisement that was filed with the NASDR and complied with standards of the NASDR and the Securities and Exchange Commission, and attempt to use the color of administrative regulation to change the content of the ad. To read NSMIA to permit such conduct is to render moot both the language and the intent of those provisions in NSMIA that were deliberately designed to eliminate state regulation that is inconsistent with federal law and the rules thereunder.³

Because states lack jurisdiction to impose any standards on investment company advertising or sales literature, whether done under the guise of a sales practices rule or otherwise, we strongly recommend that the Committee amend its proposal to expressly preclude its application to investment companies (as well as to all issuers of covered securities). To fail to do so would result in the Committee recommending to the members of NASAA that they adopt unlawful and unenforceable provisions. We believe such conduct would be irresponsible and a disservice to the members of NASAA.

If you or the members of the Committee have any questions about any of the comments made herein, or would like any additional

information, please do not hesitate to contact me at 202/326-5825.

Sincerely,

Tamara Cain Reed
Associate Counsel

cc: Members of the Sales Practices Committee

ENDNOTES

¹ The Investment Company Institute is the national association of the American investment company industry. Its membership includes 6,368 open-end investment companies ("mutual funds"), 447 closed-end investment companies, and 10 sponsors of unit investment trusts. Its mutual fund members have assets of about \$3.611 trillion, accounting for approximately 95% of total industry assets, and have over 59 million individual shareholders.

² Similarly, state authority to impose any standards upon investment company prospectuses has been preempted by NSMIA.

³ The provision in NSMIA that preserves the authority of states to investigate and bring enforcement actions with respect to fraud and deceit expressly requires that such authority be exercised in a manner "consistent with" the preemptive provisions of NSMIA. (See amendments to Section 18(c) of the Securities Act of 1933; emphasis added.)