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Highlights

Highlights of GAO-11-697, a report to congressional committees

Why GAO Did This Study

Mutual funds are one of the most widely held investment products by Americans and advertising is one method by which investors may obtain information on funds. The Dodd-Frank Wall Street Reform and Consumer Protection Act requires GAO to conduct a review of mutual fund advertising, focusing on the advertising of past performance information. This report examines (1) what is known about the impact of fund advertisements on investors, (2) the extent to which performance information is included in advertisements, and (3) the regulatory requirements for fund advertisements and how they are administered and enforced. To address these objectives, GAO reviewed existing and proposed Securities and Exchange Commission (SEC) and Financial Industry Regulatory Authority (FINRA) rules, conducted a literature review of studies related to mutual fund advertising's impact on investors, and reviewed a random sample of 300 fund advertisements. GAO also met with regulators, fund companies, academics, and industry and investor protection groups.

What GAO Recommends

To help ensure investors are better protected from misleading advertisements, SEC should take steps to ensure FINRA develops sufficient mechanisms to notify all fund companies about changes in rule interpretations for fund advertising. Both SEC and FINRA agreed with the recommendation.

View GAO-11-697.
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MUTUAL FUND ADVERTISING

Improving How Regulators Communicate New Rule Interpretations to Industry Would Further Protect Investors

What GAO Found

While some academic studies and others have suggested that advertisements that emphasize a fund's past performance can influence investors to make inappropriate investments, the evidence that investors are harmed by these advertisements is mixed. Some academics believe that because research has shown that past performance generally does not persist and is not predictive of future performance, performance advertisements are inherently misleading. However, some studies illustrate that investors who are influenced by performance advertising may still achieve returns that exceed market indexes or other funds. In addition, the extent to which investors rely on performance advertisements is unclear. Industry surveys show that investors are increasingly relying on information from financial advisors and other sources and use a variety of information—beyond performance information—when making investment decisions.

GAO's review of a random sample of mutual fund advertisements also revealed that advertising focusing on performance is generally not common. Of the six different advertising methods we included in our review—brochures, press releases, print media, the Internet, radio, and television—we estimate that 9 percent emphasized a fund's performance and 35 percent contained some type of performance information. For example, many of these included the standardized presentation of the fund's performance over a 1-, 5-, and 10-year period, and others presented information on a fund's performance ranking relative to other funds. Fund company staff noted that, although performance information is not the focus of most advertisements, investors can still seek it out from required disclosure documents or public Web sites.

Another factor that helps limit the potential for investors to be misled by fund advertising is an established regulatory review process of fund advertisements used by broker-dealers intended to be seen by the public at the time of first use. FINRA reviews all advertisements intended to be seen by the public and provides comment letters to fund companies that can require changes that must be made to advertisements or can prohibit advertisements from being used entirely. FINRA, which is overseen by SEC, also conducts special reviews on emerging industry issues at firms selling mutual funds that can help to identify potentially misleading advertisements. However, fund company representatives expressed concerns that FINRA does not always effectively communicate changes in advertising rule interpretations that arise when the regulatory staff identify concerns about new material being advertised by fund companies. Because FINRA communicates some new interpretative positions initially by making comments on advertisements submitted for its review, only those firms that submit new advertisements learn of new interpretations of existing rules. As a result, they may be competitively disadvantaged if other firms attract additional investments by continuing to use previously approved advertisements that do not comply with the new position. In addition, this uneven method of communicating changes in rule interpretations can result in investors being exposed to advertising that does meet current standards and may be considered misleading.