| asset management group

December 22, 2020

Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: **Tailored Shareholder Reports, Treatment of Annual Prospectus Updates for Existing Investors, and Improved Fee and Risk Disclosure for Mutual Funds and Exchange-Traded Funds; Fee Information in Investment Company Advertisements**
File No. S7-09-20

Dear Ms. Countryman:

The Asset Management Group (the "**AMG**") of the Securities Industry and Financial Markets Association ("**SIFMA**")[1] appreciates the opportunity to provide comments to the United States Securities and Exchange Commission (the "**Commission**" or "**SEC**") on the Commission's proposed rule and form amendments that would change the way investors receive information from open-end management investment companies (the "**Proposal**").[2]

AMG supports the goals that the Proposal seeks to achieve. The Proposal has the potential to improve the quality and effectiveness of fund disclosures, as well as to reduce costs for funds and investors. It is important for fund investors to have access to clear, accurate, transparent and timely disclosure that is appropriate for retail investors. It is also important for investors to have choice and flexibility in electing the delivery method for fund disclosures that best fits each individual investor's needs. In considering changes to how investors access information about their funds, as well as the content of such information, we urge the SEC to weigh potential unintended consequences, including investor confusion and a diminished investor experience, as well as unnecessary costs to funds and fund shareholders.

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[1] SIFMA AMG brings the asset management community together to provide views on U.S. and global policy and to create industry best practices. SIFMA AMG's members represent U.S. and global asset management firms whose combined assets under management exceed $45 trillion. The clients of SIFMA AMG member firms include, among others, tens of millions of individual investors, registered investment companies, endowments, public and private pension funds, UCITS and private funds such as hedge funds and private equity funds. For more information, visit http://www.sifma.org/amg.

[2] Tailored Shareholder Reports, Treatment of Annual Prospectus Updates for Existing Investors, and Improved Fee and Risk Disclosure for Mutual Funds and Exchange-Traded Funds; Fee Information in Investment Company Advertisements, Release Nos. 33-10814; 34-89478; IC-33963 (August 5, 2020), *available at* https://www.sec.gov/rules/proposed/2020/33-10814.pdf (hereinafter, the "*Proposal*").

I. INTRODUCTION

We offer feedback on some of the components of the Proposal below. Our comments focus on the potential impacts to funds, and their investors, of proposed changes to the disclosure framework included in the Proposal. Overall, we believe that the Proposal has been conceived and formulated in a manner that could further the important goals articulated by the Commission. These goals will only be realized, however, if certain elements of the Proposal are structured to avoid potentially diminishing the investor experience.

Our comments in this letter cover the following aspects of the Proposal:

- Proposed Rule 498B
  - Rule 498B could lead to cost savings for funds and investors and we offer suggestions to make it a more workable tool for funds
- Shareholder Reports
  - We support the creation of tailored shareholder reports
  - The SEC should reconsider changing the definition of "broad-based index"
  - We offer feedback on the material fund changes section of shareholder reports
  - We offer feedback on the proposals related to funds' statements regarding liquidity risk management programs
  - Certain fund types should be permitted to be bundled together in shareholder reports
- Content of Prospectuses
  - We agree that the presentation of risk disclosure in fund prospectuses could be improved, but are concerned that certain proposed changes present liability risk to funds as well as the potential to mislead shareholders
  - We offer feedback on several aspects of the proposed fee summary
- Delivery Framework for Shareholder Documents
  - The SEC should not amend the scope of Rule 30e-3. Instead, we urge the SEC to preserve the optionality of usage Rule 30e-3 provides as a delivery mechanism for *all* funds, including those registered on Form N-1A
  - Electronic delivery ("**e-delivery**") should be adopted as the default delivery method for shareholder documents
  - We offer additional perspective on the proposed delivery framework

II. PROPOSED RULE 498B

Under proposed Rule 498B, funds would have the ability, on an optional basis, to satisfy their prospectus delivery requirement for existing shareholders through compliance with certain conditions, including the delivery of annual and semi-annual tailored shareholder reports. Funds would be required to continue to deliver prospectuses to new shareholders for initial purchases of fund shares.[3]

Proposed Rule 498B has the potential to reduce costs and to improve the investor experience. It offers a mechanism to achieve a reduction in the number of fund documents that shareholders receive each year.

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[3] *Id.* at 227-228.

It also provides funds with flexibility to choose a delivery framework that involves fewer shareholder mailings. We offer feedback below.

A. Notice of Material Changes Requirement

As a condition of reliance on proposed Rule 498B, funds would be required to provide notice to all shareholders within three business days of certain material fund changes.[4] As proposed, the SEC prescribes a list of topics that would require notice under the Rule, with the flexibility to notify shareholders of other changes a fund considers material.[5] As proposed, our members expect this requirement to result in *additional* mailings beyond those typically mailed to shareholders today. Further, as proposed, this requirement may present costs and obstacles that would ultimately reduce the potential benefits of electing to rely on Rule 498B.

(i) Timing of Mailing

The requirement to mail notifications within three business days of a fund change presents concerns for AMG members. When a notification under the Rule is triggered by a fund change, we recommend requiring "prompt" or "as soon as reasonably practicable" notification to shareholders. Mailing a notification to shareholders requires a number of operational steps. Funds are typically reliant on vendors and other third parties to facilitate these operational steps. Given these obstacles and weighing them against the minimal benefits a rigid three-day rule provides to investors, it seems unnecessary to build into the Rule this firm requirement, especially given the mailing issues witnessed during this year's global pandemic.

(ii) Trigger for Mailing Requirement

The SEC proposes a list of topics, changes to which would trigger the shareholder notification requirement of proposed Rule 498B.[6] Although we recognize that the SEC has strived to remove subjectivity from the process, the reality is that subjectivity is part of a materiality analysis. Determining what information is material and should be provided to investors is a core obligation of funds that they take seriously and execute with great care. We do not believe that a prescriptive list of topics triggering shareholder notification would be useful to investors or provide them with more beneficial information than they would receive from a fund fulfilling its existing materiality obligations.

However, to the extent the SEC determines to include such a list of topics in any final rule, we urge the SEC to provide some additional guidance to assist funds in determining whether a "material" change has occurred with respect to any of the enumerated topics, requiring prompt notification to shareholders, or needs to be called out specifically in the fund's annual shareholder report. For example, funds could be required to consider certain relevant factors such as: (i) what is the nature of the change and does it reflect a change in the way the fund is currently being managed and/or does it reflect a material change in the fund's risk profile, (ii) which section(s) of the prospectus does the change impact, (iii) how likely would the change be to influence a shareholder's decision to continue to invest in the fund, and (iv)

[4] *Id.* at 248.

[5] *Id.* at n. 517 and accompanying text.

[6] *Id.*

what is the length of time before existing shareholders will have "access" to the information (*e.g.*, in the event it is simply folded into the annual prospectus update that will be accessible to shareholders on the fund's website). The list included in the Proposal could be included as the types of changes that are most commonly deemed material, but we strongly suggest removing portfolio manager changes (which are rarely material) from the list. This approach would avoid (a) an excessive number of mailed shareholder notifications, and (b) a laundry list of changes made to a fund's prospectus disclosure (that would be of limited utility for investors) included in shareholder reports.

Additionally, without modification, the proposed delivery framework for fund changes could result in shareholder confusion and a diminished investor experience. For example, if a potentially "non-material" change that a fund conservatively deemed "material" was sent to shareholders shortly before an annual report containing fund changes, shareholders would see the change twice in close proximity, despite it potentially not being critical information for retail shareholders. Our above suggestions help to mitigate this concern and aim to result in communication to shareholders of only the most important types of fund changes. This result, in turn, would allow funds to realize significant cost savings under the proposed Rule.

B. Operational Considerations

We believe the definition of "existing shareholder" is unnecessarily complicated and may be difficult to comply with. We strongly suggest that the concept of a "continuous holder" be removed from any final definition. Funds should be able to rely on Rule 498B with respect to any current shareholder on record as of the date of the annual prospectus update, regardless of whether that shareholder was a continuous holder of shares or not.

We understand that the proposed delivery regime that bifurcates the world into funds relying on 498B and those not relying on 498B could be challenging for broker-dealers to integrate into their processes. We are concerned about the operational risks this might present, and the additional costs required to systematize the Rule into current processes. Additional fees could be charged to funds in the event unduly complicated "categories of shareholders" must be tracked or in the event dual systems must be created to support those fund complexes who chose to rely on Rule 498B and those who do not. This could create unintended additional costs, which will ultimately be borne by fund shareholders. We believe any final rule should seek to minimize complexity and technicalities with respect to the universe of shareholders so that a fund may rely on Rule 498B as much as possible.

III. SHAREHOLDER REPORTS

A. Tailored Shareholder Reports

In the Proposal, the SEC proposes the creation of new tailored shareholder reports to replace current annual and semi-annual shareholder reports. AMG is supportive of the creation of the summary form documents, and we agree that most retail investors would benefit from shorter and more readable shareholder reports with content that is tailored to retail investors. The content of the reports proposed by the SEC largely makes sense. Below we suggest a few changes to the content intended to improve the tailored shareholder reports and to reflect information most appropriate, useful and important for retail investors.

B. Change to Definition of Broad-Based Index

In the Proposal, the SEC proposes a change to the definition of "broad-based index" to mean one that represents the overall applicable domestic or international equity or debt markets.[7] The changed definition would impact performance reporting both in fund shareholder reports and fund prospectuses. For several reasons, we urge the SEC *not* to adopt this change as proposed until further impact analysis is done to understand the potential consequences of the change.

In proposing the changed definition, the SEC is attempting to facilitate more efficient comparability across similar funds. This is an important objective, but we do not think amending the definition as proposed is the best way to achieve it. For example, a blended fund holding both equity and fixed income securities would be required to choose between an equity or fixed income index to use as its primary benchmark. Two similar funds may choose different primary benchmarks (*e.g.*, one equity, one fixed income) which would not ultimately result in better comparability between those funds. Although each fund in this example could adopt a secondary index to compare its performance to, which could enable shareholders to compare the funds' performance more accurately, this is not required under the Proposal. This proposed change could end up diminishing the investor experience as it relates to the usefulness of performance reporting.[8]

Another case where the Proposal's mandate to compare the fund's performance to the overall equity or debt markets could diminish the investor experience is with certain alternatives strategies. For example, many of these funds are specifically designed to have no (or extremely low) correlation to either equity markets or fixed income markets; therefore, use of a broad-based equity or bond index would not provide a useful performance comparison and may be misleading to investors. In fact, a statistical analysis of returns generally shows that alternative strategy returns correlate to the returns provided by risk-free investments (*e.g.*, cash or U.S. treasury bills) and are not correlated to equity or fixed income markets. In this respect, alternative strategy funds have found cash-oriented benchmarks to be a more suitable performance benchmark for those that seek returns with low correlations to traditional asset classes. Any final rule should ensure that these types of funds are able to provide investors with a performance benchmark that appropriately reflects the returns objective of the fund, even where that benchmark is cash-oriented rather than reflective of a broad-based traditional asset class.

The SEC's proposal to change this definition is intended to enhance comparability between similar funds. The change, however, could end up misleading investors and providing them with a performance metric that is less useful than a fund's current performance benchmark index. Investors purchase funds to gain access to certain desired markets, asset classes and investment strategies. Typically, each fund held is part of an investor's overall investment portfolio which may include other open-end funds, as well as other securities. To the extent an investor is evaluating her portfolio for potential adjustments, relevant factors she might consider include: her risk tolerance compared to the current risk profile of her overall investment portfolio, current market conditions and their impact on each investment in the portfolio, and how each individual fund in the portfolio has performed during the period since her last

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[7] *Id.* at 98-99.

[8] Additionally, when selecting an index, some judgment is involved as to how broad an index should be. For example, the Bloomberg Barclays U.S. Aggregate Bond Index does not include high yield and the S&P 500® Index does not include all market capitalizations. A so-called "broad-based index" is not strictly representative of the overall debt or equity market.

portfolio evaluation. For this last factor, in this example scenario, it would not be helpful for the investor to see a fund's performance compared to an index that does not measure the market cap or asset class that such fund invests in. The SEC says in the Proposal that funds should be comparing their performance to "the overall applicable stock or bond markets, as applicable," in order to provide investors with a sense of "how their investments might have performed had their money been invested elsewhere."[9] Comparing a fund to a broad-based index, however, would only permit investors to see how their money would have performed if invested in funds tracking that broad-based index, which is a very narrow sub-set of funds. If this comparison is intended to give shareholders relevant data that might drive them to specific actions (*e.g*., evaluating an overall investment portfolio), what the SEC proposes is not the most relevant data point. An investor typically holds a particular fund for the strategy/exposure it offers, and a more relevant comparison is to an appropriate performance benchmark.

Additionally, the operational and index licensing costs to funds, and ultimately shareholders, to implement the required changes in order to comply with the changed definition would not be trivial.[10] We believe any marginal benefits that might result from this change would be eclipsed by the costs involved.

C. Material Fund Changes

The SEC proposes a new section to annual shareholder reports that would describe "material changes to the fund" since the beginning of the reporting period, or that the fund plans to make during the upcoming annual prospectus update.[11] As proposed, the types of changes required to be included in this section would be the same as those proposed to trigger shareholder notification under proposed Rule 498B (discussed above).[12] We support the concept of shareholders receiving a summary of changes to their funds that occurred over the past reporting period. We suggest several modifications to the way this proposed section is structured.

(i) Determination of Materiality

As discussed above,[13] we urge the SEC to provide guidance to funds to ensure the list of fund changes included in annual reports is limited to only those changes that would be important for a retail shareholder to be informed of during an annual review of their fund holdings. The types of changes that should be included are those that impact the management of the fund or the fund's risk profile in a material way. This approach would avoid a result where funds include a cumbersome list of changes that would both increase the length of the annual report while potentially having a dilutive effect on the

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[9] *Proposal* at 95, 98.

[10] These costs may include licensing fees charged by index providers, the costs related to attaining necessary Board approvals, the costs of updating funds' disclosures for these changes and associated updates to marketing and other materials where fund indexes are used.

[11] *Proposal* at 131-41.

[12] *See, supra,* Section II.A.

[13] *See, supra*, Section II.A(ii).

important changes that a retail shareholder should be made aware of. Additionally, we do not think the inclusion of a fund changes section in shareholder reports should impact the current processes that funds use for determining whether a 485a filing is necessary for annual prospectus updates.

(ii) Do Not Require Forward-Looking Changes

The SEC proposes requiring funds to include changes that the fund anticipates making as part of its upcoming annual prospectus update.[14] We suggest removing this requirement. Ensuring compliance with this aspect of the Proposal would be operationally challenging for several reasons. The timing of fund changes is often unpredictable, and changes are often not finalized in time to meet necessary production schedules for annual reports. This requirement would introduce operational risk and potentially lead to disclosure inconsistencies or errors that would require additional disclosure and shareholder notification to remedy, which could ultimately lead to investor confusion or a diminished investor experience. As an alternative, to enhance accuracy and certainty, the requirement could be limited to include only changes that have been definitely determined, by a fund's adviser, to be anticipated as part of the upcoming annual prospectus update. Including a fund changes section in semi-annual reports is another way to help address the objectives underlying the forward-looking changes aspect of the Proposal. This would provide another opportunity for shareholders to receive information about changes to their funds.

D. Statement Regarding Liquidity Risk Management Programs

As part of the SEC's proposed tailored shareholder reports, a fund's statement regarding its liquidity risk management program ("**LRMP**") would be included in the report.[15] Additionally, the SEC is proposing changes to the required LRMP statement so that the statement would be tailored to each fund and not generic.[16] We do not think this information is useful for retail investors and believe that it should not be included in tailored shareholder reports and instead should be moved to form N-CSR. Regardless of where the disclosure is located, however, we think funds should be permitted to retain standardized statements across funds, unless a fund has unique liquidity features (*e.g.,* the fund has a highly liquid investment minimum) or its LRMP is uniquely different than other funds in a complex.

(i) Changes to LRMP Statement

The SEC proposes changes to the disclosure requirements for funds' statements regarding their LRMPs. The current requirement would be replaced with a brief summary of the key factors that affected the fund's liquidity during the period, the key features of the fund's LRMP and a summary of the effectiveness of the fund's LRMP during the reporting period.[17] We do not feel it is necessary or beneficial to require that this disclosure be customized to individual funds in all cases. Funds have

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[14] *Proposal* at 134.

[15] *Id.* at 150.

[16] *Id.*

[17] *Id.*

established their LRMPs over the past several years[18] to function as "umbrella programs," similar to other well-established processes, such as fair valuation. LRMPs are managed across fund complexes and many elements of LRMPs are implemented in a standardized manner across funds. Disclosures regarding LRMPs should reflect the way liquidity is managed across a fund complex. These disclosures are frequently identical or very similar for many, if not most, funds in a complex. Only funds that present unique liquidity features or challenges should be required to tailor their LRMP statements. This approach would require the appropriate level of compliance and investment risk resources – allowing funds and advisers to focus on LRMP reporting and disclosure for only certain funds.

(ii) Inclusion of LRMP Statement in Tailored Shareholder Reports

The tailored shareholder report is intended to be the main document shareholders receive about their fund investments.[19] The document is intended to include information appropriate for retail investors. Not only do we feel that LRMP statements do *not* fall into this category of information, investors themselves do not feel this information is useful.[20] The effectiveness of a fund's management of liquidity risk is already reflected for shareholders in the fund's performance – information which is readily available for retail shareholders. LRMP statements provide an abstract summary of a compliance program that oversees liquidity risk management. It would be confusing for shareholders to see this information alongside other, more retail shareholder-oriented fund information and give outsized importance to the risk that a shareholder might not be able to redeem her shares when desired, which is in fact a rare occurrence.

As an alternative approach, funds could be required to include LRMP statements only under certain circumstances, such as holding a certain minimum percentage of assets in "less liquid investments," as defined by Rule 22e-4.[21] For all other funds, the LRMP statement could be included in the fund's Form N-CSR. This approach would be more suitable for a retail investor audience that could realize benefits of knowing when and for which funds this disclosure is important. Removing this requirement or amending it as we suggest would also further the SEC's goal of shorter, more concise shareholder reports that are tailored to retail investors.

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[18] Final Rule, Investment Company Liquidity Risk Management Programs, Release Nos. 33-10233; IC-32315; File No. S7-16-15 at 307 (Oct. 13, 2016), *available at* https://www.sec.gov/rules/final/2016/33-10233.pdf (noting the compliance dates for large funds (December 1, 2018) and smaller funds (June 1, 2019)).

[19] *Proposal* at 38.

[20] *See* comments filed in response to the Proposal and its accompanying sample tailored shareholder report, *available at* https://www.sec.gov/comments/s7-09-20/s70920.htm. As of December 22, 2020, 12 out of the 23 responses submitted through the Shareholder Report Feedback Flyer (*located at* https://www.sec.gov/rules/proposed/2020/im-shareholder-report-ff html) indicated that the LRMP statement included in the SEC's sample shareholder report was not useful; *see, e.g.* Comment Letter of Olivia Brightly (November 24, 2020), *available at* https://www.sec.gov/comments/s7-09-20/s70920-8055609-225814.htm (stating that the section of the sample shareholder report regarding LRMP disclosure is "not useful" and "I just care that I can get money out. I do not care about the how.") Notably, the Proposal and its accompanying sample tailored shareholder report provides investors the first opportunity to react to LRMP content directly, as sample reports reviewed by investors in connection with the SEC's 2018 RFC on Fund Retail Investor Experience and Disclosure (Release Nos. 33-10503; 34-83376; IC-33113 (June 5, 2018)) did not include LRMP statements.

[21] Rule 22e-4(a)(10), 17 C.F.R. §§ 210, 270, 274 (2020).

E. Structure of Tailored Shareholder Reports

In addition to specifying the content permitted in funds' annual and semi-annual shareholder reports, the SEC proposes to require each fund to prepare a separate report that covers information for only that fund. Today, registrants are able to, and frequently do, include multiple funds in shareholder reports. We urge the SEC to consider allowing certain funds to "bundle" shareholder reports together where such bundling would make sense for funds and be beneficial for shareholders. The fund types we suggest be permitted to be combined into one shareholder report are variable annuity funds, target date funds, target risk funds, and state tax-exempt funds. These fund types typically have similar investment strategies and risk profiles, such that funds could realize efficiencies in presenting information in a combined fashion. Additionally, updates to funds within a fund type are frequently common across the similar funds. Bundling similar funds together in a single shareholder report would also serve as an important tool for shareholders in assessing their current fund holdings, and in considering potential changes to their investment portfolios.

IV. CONTENT OF PROSPECTUSES

A. Treatment of Principal Risks

The Proposal includes changes to the presentation of risks in fund prospectuses intended to improve risk disclosure to make it more clear, succinct and tailored to each fund.[22] While we agree with the SEC that overly lengthy principal risk disclosure is not always helpful or informative to retail investors, we have concerns with several aspects of this section of the Proposal and do not feel certain proposed changes, as explained below, would improve risk disclosure as envisioned by the SEC.

(i) Inclusion of Only Principal Risks

The Proposal would specify in the instructions to Form N-1A that a fund could not include non-principal risks in its prospectus.[23] We agree with this proposed instruction, which is designed to improve the quality and reduce the length of risk disclosure sections in fund prospectuses. Inclusion of non-principal risks dilutes the prominence of the principal risks that investors should be focusing on when reviewing a fund's prospectus.

(ii) Determination of Principal Risks

The Proposal also includes a new instruction to Item 9(c) of Form N-1A that instructs funds, in determining whether a risk is principal, to consider whether the risk would put more than 10% of a fund's assets at risk and whether it is reasonably likely that a risk will meet this 10% standard in the future.[24] We do not think the SEC should adopt this instruction.

As proposed, the 10% instruction is open to interpretation and could result in wide variation across similar funds on *how* the assessment is applied. The Proposal does not provide direction as to how a

[22] *Proposal* at 309.

[23] *Id.* at 310.

[24] *Id.* at 314.

fund should measure whether more than 10% of a fund's assets are "at risk." In fact, the SEC inquired as to whether there should be a numerical standard associated with the instruction for determining whether a risk is a principal risk, and if so, what quantitative or other criteria should inform this standard.[25] Additionally, the Proposal acknowledges that a fund could also determine that it should disclose a "principal risk" in some circumstances when the fund uses less than 10% of its assets to make investments, specifically when those investments may subject the fund to a risk of loss of more than 10% of its assets, citing as examples, a fund that engages in short sales or derivatives trading.[26] The lack of a clear standard for measurement of the "10% of assets at risk" instruction would likely result in differences among funds in the methodology selected, which in turn could result in differences in principal risk factors among funds with similar risk profiles. In addition, funds could reasonably reach varied conclusions as to whether a fund is "reasonably likely" to reach the 10% threshold in the future. These factors could decrease comparability in principal risk factors among funds with similar risk profiles and suggest a false precision to investors regarding the identification of principal risks.

While we do not disagree with the concept that an evaluation of the risk to a fund's assets should be considered when determining which risks are principal, the instruction as proposed would likely *increase* the number of principal risks included in funds' disclosure, which would be contrary to the objectives of the Proposal. The exercise of determining which risks are principal to a strategy, and periodically reviewing and confirming these determinations, is primarily a portfolio management and investment risk function and frequently does not lend itself to a simple quantitative measurement. The instruction as proposed may also lead to the inclusion of more risks in funds' disclosure because funds will be over-inclusive in reaction to the "reasonably likely that a risk will meet this 10% standard in the future" language in the proposed instruction.[27] It is important for funds to have flexibility to tailor risk disclosure as appropriate depending on holdings, market conditions and portfolio management's outlook and expectations for the coming period, among other factors. A quantitative measure could impede this essential process.

Additionally, strict adherence to the proposed 10% instruction could result in unintended consequences of funds omitting risk factors that while not considered "principal" pursuant to the instruction might nonetheless become "principal" if portfolio management is confronted with market conditions that require unexpected changes in investment allocations. For example, if a hypothetical XYZ Equity Fund could invest up to 15% of its assets in fixed income securities but does not currently hold (nor expects to hold) more than 5% in fixed income securities, it may nonetheless be prudent to include fixed income risks in the fund's prospectus in the event that the fund's portfolio allocation were to shift. A fund's risk disclosure is highly dependent on the asset classes the fund invests in, the fund's flexibility to move in and out of asset classes, the fund's investment methodology, the fund's use of third-party information as part of an investment strategy, and other factors that contribute to the fund's portfolio management approach.

The 10% instruction could result in unintended consequences of funds lengthening their risk disclosures and potentially leaving out important risks that funds might otherwise consider truly principal and,

[25] *Id.*

[26] *Id.*

[27] *Id.*

consequently, has the potential to mislead or confuse investors. We suggest the SEC *not* adopt the 10% instruction and instead allow funds to use any reasonable method to determine which risks are principal risks to a fund.

(iii) Order of Risks

The Proposal includes a proposed instruction to list risks disclosed in the summary prospectus in order of importance and specifically precludes alphabetical order.[28] We understand that the SEC's objective with this proposed requirement is for funds to convey the relative importance of risk factors through the order they appear in a fund's summary prospectus. Certain AMG members have significant concerns with this approach and strongly urge the SEC not to adopt this proposed instruction.

We are primarily concerned with the liability risk this proposed instruction would expose funds to. Requiring a fund to determine the relative degree each of its risks will impact its portfolio in the coming year is setting the stage for second-guessing and potential litigation. Additionally, as market conditions change throughout the year, resulting in impacts to a fund's risk profile, this requirement could result in an excessive number of prospectus supplements (and potentially notices of fund changes required under proposed Rule 498B) mailed to shareholders.

A fund's principal risk disclosure should inform a shareholder that *all* risks included are principal risks, that *all* risks have the potential to be more significant in certain market environments, that *all* risks may result in losses or adversely impact fund performance, and that shareholders should consider the principal risks in their totality when evaluating an investment in the fund. The order of risks is not nearly as important as ensuring that investors know that all principal risks included are important for them to consider in making an investment decision.

AMG members employ varying practices in presenting their funds' risk disclosure today and feel there are multiple ways to effectively disclose a fund's risk factors to shareholders. Importantly, shareholders are accustomed to seeing prospectus risks in a variety of presentations. Requiring all funds to present risks in a single uniform fashion would convey a sense of false precision to shareholders.

Requiring funds to present risks in order of the risk posed to fund assets could lead investors to discount certain risks that are listed later in a fund's principal risk section, which in certain market environments may in fact be more important than earlier listed risks. More important than the order of risks, the lead-in to a fund's principal risks section should direct shareholders to consider each risk factor listed as "principal." Risks are as dynamic as the changing market conditions that impact fund investments and investment strategies. The relative risk posed by the principal risks of a fund will invariably change over time, particularly in periods of significant market volatility.[29] In many cases, it is challenging or impossible to anticipate how each principal risk factor might impact a fund's portfolio over the coming year. To require all principal risks be ordered by relative importance could result in disclosure that could be misleading to shareholders to the extent that the level of risk changes over time, and the relative

[28] *Id.* at 312.

[29] *See e.g.*, 2020.

degree of misleadingness could vary across shareholders who purchase at different points throughout the year.

Notably, the SEC has specifically not required the proposed risk presentation in other contexts. In adopting recent disclosure changes to Regulation S-K, the SEC considered and rejected requiring operating companies to order risks by perceived importance.[30] We see no valid reason to subject funds to a different disclosure standard than operating companies in this regard. We strongly encourage the SEC to reconsider this aspect of the Proposal and retain the current principles-based approach to risk disclosure that provides flexibility in the manner funds present principal risks. The clear costs this proposed instruction presents (*e.g.*, investor confusion and litigation risk for funds) would significantly outweigh the very uncertain benefits that may not even be realized.

B. Proposed Revisions to Fee Table

In the Proposal, the SEC proposes a number of changes to prospectus disclosure about fund fees.[31] The main change the SEC proposes is the creation of a new "fee summary" to be included in summary prospectuses and summary sections of statutory prospectuses.[32] We agree with the SEC that fees are of paramount importance to investors when making an investment decision, and disclosure regarding fee information should be clear, accurate and easy for investors to digest. We support certain changes the SEC proposes to funds' fee disclosure, but do not support the substantial changes to the structure of the fee table that investors are so accustomed to seeing in fund prospectuses.

(i) New Fee Summary

The Proposal includes a number of changes to the terminology used in the proposed new fee summary.[33] For example, "shareholder fees" would become "transaction fees" and "annual fund operating expenses" would become "ongoing annual fees." We hesitate to support all of the terminology changes for several reasons. First, shareholders are accustomed to the terminology used in current fee tables, which they have been seeing in prospectuses for many years. These changes could contribute to investor confusion without adding much value to the investor experience. We do not think the current terminology is so unclear as to justify shifting to new terminology. Second, implementation of the proposed terminology changes would involve significant operational resources. We question whether the operational costs[34] are worth the marginal benefit, if any, the new terminology offers.

Additionally, we believe all investment-related expenses (including interest expenses incurred on borrowings and TOBs) should be excluded from the fee table. These types of expenses could be

[30] Regulation S-K Items 105, 17 C.F.R. §§ 229.105 (2020).

[31] *Proposal.* at 262.

[32] *Id.* at 267.

[33] *Id.* at 271.

[34] These costs include, among others: updating marketing materials, updating webpages, producing investor education materials, training call center personnel, updating back office functionalities for disclosure production, reporting and other processes.

included in a fund's Statement of Additional Information instead. Interest expenses are more akin to transaction costs (such as brokerage commissions, which are excluded from the fee and expense table) incurred in implementing a fund's investment strategy, as opposed to a fund's more traditional operating costs associated with audit, legal, custody, and transfer agency services. As such, investment-related expenses are not as relevant to a retail investor in reviewing a fund's fee table.

The SEC also proposes to retain the current fee table which would be located in the back portion of a fund's statutory prospectus. This requirement would be confusing to shareholders and would be costly and operationally burdensome for funds. We suggest eliminating this aspect of the Proposal to avoid presenting two different fee tables with similar information that would likely lead to investor confusion.

(ii) Acquired Fund Fees and Expenses

The Proposal also includes modifications to refine the scope of funds that are required to disclose Acquired Fund Fees and Expenses ("**AFFE**") as a line item in their fee summaries.[35] Funds that invest 10% or less of their total assets in underlying funds would be permitted to omit AFFE as a line item and instead include the fund's AFFE in a footnote to the fee summary (and the fee table in the back part of the fund's prospectus). We are supportive of this change to funds' presentation of AFFE.

We are particularly supportive of this change and its impact on business development companies ("**BDCs**"). We would support BDCs being carved out of the AFFE completely (similar to the carve-out permitted for REITs[36]), but acknowledge that the 10% threshold is a positive step in supporting the BDC community. We encourage the SEC to further explore exempting BDCs from inclusion in AFFE reporting.

(iii) Investment-Related Expenses

We additionally believe all investment-related expenses (including interest expenses incurred on borrowings and TOBs and dividends paid on short sales) should be excluded from the fee table.

The fee table is most useful to retail investors as a way to compare funds' traditional operating costs associated with audit, legal, custody and transfer agency services. These costs are common across funds and give a standard point of comparison. On the other hand, investment-related expenses are much different and are unique to the way that each fund seeks to implement its investment strategy. As a result, these expenses do not provide a standard point of comparison across funds and in fact could provide misleading information to investors. For example, even funds that employ similar investment strategies may choose to implement those strategies in different manners. Funds utilizing certain approaches to implementation (*e.g.*, shorting physical securities vs. shorting via the use of derivatives) may appear to be more expensive than similar strategies using different methods of implementation if investment-related expenses are included in the fee table. Yet these funds would be incurring investment-related expenses because they believe the implementation method will ultimately result in

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[35] *Proposal* at 293.

[36] Comment Letter from Joseph Glatt, Chairman, Coalition for Business Development, to Vanessa Countryman, Acting Secretary, Securities and Exchange Commission, at 3 (May 2, 2019), *available at* https://www.sec.gov/comments/s7-27-18/s72718-5441142-184822.pdf (noting that REITs are not subject to AFFE disclosure and that BDCs operate in a similar manner to REITs).

greater overall return for investors. Including these expenses in the fee table may ultimately fail to give investors an accurate understanding of a fund's fees and at the same time discourage approaches to implementing a strategy that may ultimately benefit fund investors.

V. DELIVERY FRAMEWORK FOR SHAREHOLDER DOCUMENTS

A. Rule 30e-3 Should Not be Amended

In the Proposal, the SEC proposes to amend the scope of Rule 30e-3 to exclude mutual funds and ETFs registered on Form N-1A.[37] If amended as proposed, these funds would no longer be able to use "notice and access" for delivery of shareholder reports as currently will be permitted by Rule 30e-3 starting as early as January 2021.[38] The SEC should consider preserving the optionality of Rule 30e-3 for all funds (including those registered on Form N-1A) as originally adopted for a number of reasons.

Rule 30e-3 notice and access for delivery of shareholder reports provides benefits to both funds and shareholders. Certain funds are planning to start utilizing notice and access delivery under Rule 30e-3 over the course of the next year. Many fund complexes have invested considerable time and money in developing systems and compliance programs to comply with Rule 30e-3, and have been considering such programs since 2015 when the Rule was initially proposed.[39] Certain funds and fund shareholders can still benefit from those investments.[40] The incremental cost of retaining Rule 30e-3 is near zero. Removing it would increase costs to undo work that has already been done (*e.g.,* notification to shareholders of the change and amending processes), and would render the costs already borne for naught.

Many fund shareholders have been anticipating notice and access for delivery of shareholder reports for over a year now, since funds first started using the 30e-3 disclaimer on the front cover of documents. Many AMG members plan to begin using this delivery method starting in 2021. To amend the scope of 30e-3 will mean that shareholders will receive 30e-3 notices for a period of time and then, at some point, start receiving the tailored shareholder reports as paper documents in the mail again. This result is contrary to the goal of improving and simplifying the investor experience.

We understand that the SEC believes that direct transmission of shareholder reports would provide a better investor experience than a notice and access model.[41] We agree with this sentiment to the extent "direct transmission" captures e-delivery as well. But, taking 30e-3 away as an option, even if funds are given the opportunity to use e-delivery as their default delivery method, is essentially taking choice

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[37] *Proposal* at 257.

[38] Final Rule, Optional Internet Availability of Investment Company Shareholder Reports, Release Nos. 33-10506; 34-83380; IC-33115; File No. S7-08-15 at 28-34 (June 5, 2018), *available at* https://www.sec.gov/rules/final/2018/33-10506.pdf.

[39] Proposing Release, Investment Company Reporting Modernization, Release Nos. 33-9776; 34-75002; IC-31610; File No. S7-08-15 (May 20, 2015), *available at* https://www.sec.gov/rules/proposed/2015/33-9776.pdf.

[40] For example, funds with a majority of direct-held accounts and funds held primarily through insurance company separate accounts may find Rule 30e-3 to be more cost effective than delivering tailored shareholder reports.

[41] *Proposal* at 259.

away from shareholders who would prefer notice and access over receiving full paper documents *or* electronic documents. We do not believe the change is justified. It seems counterintuitive to require paper reports, even shorter reports, to be mailed to shareholders, especially if the shareholders have not requested paper reports and have been given notice of the opportunity for such paper election over the past two years. Ultimately, we believe all funds, including funds registered on Form N-1A, should continue to have the *option* to utilize Rule 30e-3 or not as a delivery mechanism for shareholder reports, depending upon the specific fund complex's distribution model and whether or not use of Rule 30e-3 is expected to result in an overall benefit with respect to the fund complex in question, taking into account all relevant considerations (*e.g.*, cost savings, operational risk and/or compliance risk).

Rule 30e-3 is not inconsistent with other components of the present rulemaking. The new tailored and concise shareholder reports could be delivered via "notice and access" as easily as current full reports. Rule 30e-3 allows and encourages investors to access fund documents electronically where they can digitally interact with the content. Requiring paper documents to be mailed to shareholders discourages this. We are sensitive to the fact that some fund complexes may believe that printing and mailing a new tailored, short and concise shareholder report may be more beneficial from a cost perspective for fund shareholders than would be sending a Rule 30e-3 notice where "notice and access" fees are charged with respect to sending a 30e-3 paper notice to shareholders who hold their fund shares in "street" name. This is why we believe preserving the *optionality* of Rule 30e-3 would be beneficial for the industry. We recommend moving forward with certain elements of the Proposal (including tailored shareholder reports) while continuing to permit funds registered on Form N-1A to rely on Rule 30e-3 should they elect to do so.

B. E-Delivery Should be the Default Delivery Method

We strongly urge the SEC to consider pursuing the ability of funds to implement e-delivery as the default delivery method for shareholder documents and communications.[42] An e-delivery regime would benefit funds and shareholders. Under such a regime, however, funds should be required to provide shareholders clear and ample opportunity to opt-in to receive paper shareholder documents and communications at any time.

Many shareholders are accustomed to receiving information electronically, as many AMG members already have e-delivery processes in place, implemented in accordance with SEC guidance.[43] We also understand that relatively few shareholders have opted out of receiving shareholder documents via notice and access as the default under Rule 30e-3.[44] E-delivery reduces printing and mailing costs and saves the time involved in the printing and mailing processes. Electronic versions of shareholder documents allow for dynamic interaction between a shareholder and a fund – including hyperlinking to

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[42] *See generally*, SIFMA, *E-Delivery: Modernizing the Regulatory Communications Framework to Meet Investor Needs for the 21st Century* (Sept. 2020), *available at* https://www.sifma.org/wp-content/uploads/2020/09/E-Delivery-Paper.pdf.

[43] Use of Electronic Media, Release Nos. 33-7856; 34-42728; IC-24426 (May 1, 2000), *available at* https://www.sec.gov/rules/interp/34-42728 htm; Use of Electronic Media for Delivery Purposes, Release Nos. 33-7233; 34-36345; IC-21399 (Oct. 6, 1995), *available at* https://www.sec.gov/rules/interp/33-7233.txt.

[44] Anecdotally, one large AMG member reported that less than 0.5% of fund shareholders who have been receiving fund reports with 30e-3 notices on the covers have requested paper copies going forward.

other documentation in furtherance of the SEC's objective of layered disclosure. Less paper means less of an impact on the environment as well.

The potential risks to shareholders of an e-delivery default regime could be mitigated with appropriate controls and provisions. For example, all electronic communications to shareholders could be required to include a notification and link for shareholders to conveniently request paper copies of individual reports, or to elect paper for all reports going forward.[45] The benefits of lower costs to funds (and ultimately shareholders) and more convenient access to fund documents would outweigh any potential risks to shareholders and contribute to an improved investor experience. This has never been as clear as it is now as the industry, and the world, contends with the challenge of a global pandemic and a regulatory framework that, in the words of Chairman Clayton, "cling[s] to the mails and paper as the default or preferred paradigm for communications."[46]

C. Additional Observations on the Delivery Framework

With the Proposal, the SEC is striving to create new tailored shareholder reports and at the same time make these new documents the primary shareholder documents that existing shareholders will receive and use to evaluate their fund holdings.[47] We are supportive of the objectives to streamline shareholder documents, reduce the length and complexity of information shareholders receive, and create a layered disclosure experience for investors that ultimately leads to an improved overall investor experience.

Electing to comply with Rule 498B as proposed, however, may end up being more costly than the current prospectus delivery regime. Our members have done some preliminary cost estimates, and many have not concluded that there would be sufficient cost savings to justify changing current practices and associated processes and procedures that work well today, particularly if the Rule is adopted as proposed. In many cases, it may not be feasible to coordinate timing of fund changes with the fund's fiscal year end and the preparation of the fund's annual report. In a given year, if a fund has more than one fund change that triggers the notice requirement under proposed Rule 498B(c)(2) with respect to the topics listed in proposed Item 27A(g) of Form N-1A and these changes cannot be neatly orchestrated to coincide with the preparation of the fund's annual report, this could result in more mailings to the fund's existing shareholders than if the fund had simply mailed shareholders one annual prospectus update. For example, funds often make changes to items that would arguably fall within the categories of topics listed in Item 27A(g), and funds may (or may not) supplement the fund's prospectus with respect to those changes mid-cycle depending on the facts and circumstances. Even if a supplement is filed mid-cycle, that does not necessarily mean the change is important enough to justify mailing the supplement to all existing shareholders. Sometimes changes may occur, or enhancements may be made, that ought to be immediately supplemented so that those buying new shares of the fund have the latest most up-to-date information, but such changes may not justify the expense and cost associated with requiring "immediate" notification to all existing shareholders. Rather, existing shareholders that do not otherwise purchase new shares in the interim can be informed of the change when they get their annual prospectus

[45] If Rule 30e-3 is an option going forward, such notification and link could also include a selection to elect to receive future fund documents via notice and access.

[46] *See* Jay Clayton, Chairman, Sec. & Exch. Comm'n, Opening Remarks at the Asset Management Advisory Committee (Nov. 5, 2020), *available at* https://www.sec.gov/news/public-statement/clayton-amac-2020-11-05.

[47] *Proposal* at 47-48, 64-65.

update. We do not feel that proposed Item 27A(g) and Rule 498B adequately capture the complexities and practical realities of the decisions funds make as routine business matters. As a result, the costs associated with relying on Rule 498B may eclipse the potential benefits to funds and shareholders that it offers.

We strongly urge the SEC to provide more guidance on the materiality threshold for purposes of deciding what fund changes require immediate shareholder notification, as well as what fund changes are required to be affirmatively called out for shareholders in shareholder reports in order to guard against the shareholder report becoming a repository for a laundry list of changes that may be of limited utility to a retail fund shareholder seeking to understand any key, critical changes that have been made to the funds they hold. Such guidance would offer the fund industry a more workable tool for delivery of shareholder documents and ultimately contribute to an enhanced investor experience through better disclosure in shareholder reports.

VI. CONCLUSION

SIFMA AMG appreciates the opportunity to provide these comments, and sincerely appreciates your consideration of our feedback. We would be pleased to further engage on the comments contained in this letter, or on the Proposal generally. Please do not hesitate to contact Timothy Cameron at [redacted], Lindsey Keljo at [redacted], or our outside counsel, Morgan, Lewis & Bockius LLP, at [redacted], with any questions.

Sincerely,

Timothy W. Cameron, Esq.
Asset Management Group – Head

Securities Industry and Financial Markets Association

Lindsey Weber Keljo, Esq.
Asset Management Group – Managing Director and Associate General Counsel

Securities Industry and Financial Markets Association

cc: Honorable Jay Clayton, Chair, U.S. Securities and Exchange Commission
Honorable Hester M. Peirce, Commissioner, U.S. Securities and Exchange Commission
Honorable Elad L. Roisman, Commissioner, U.S. Securities and Exchange Commission
Honorable Allison Herren Lee, Commissioner, U.S. Securities and Exchange Commission
Honorable Caroline A. Crenshaw, Commissioner, U.S. Securities and Exchange Commission
Ms. Dalia Blass, Director, Division of Investment Management, U.S. Securities and Exchange Commission