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December 21, 2020

Ms. Vanessa Countryman
Secretary
US Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: *SEC Proposal on 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 Investment Company Institute[1] commends the Commission for examining the disclosure preferences of retail investors in registered investment companies and developing a proposal intended to give investors the disclosure they need to make informed investment decisions.[2] The fund industry has invested substantial time and resources over the past four decades in ongoing efforts to improve fund disclosure.

The importance of doing so is clear. With millions of investors choosing funds to save for retirement, education, and other important financial goals, it is critical that those investors and the financial professionals who assist them have ready access to the information they want and need in a form they can use.[3]

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[1] The Investment Company Institute (ICI) is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's members manage total assets of US$25.8 trillion in the United States, serving more than 100 million US shareholders, and $8.3 trillion in assets in other jurisdictions. ICI carries out its international work through ICI Global, with offices in London, Hong Kong, and Washington, DC.

[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*, SEC Release Nos. 33-10814; 34-89478; IC-33963 (Aug. 5, 2020), ("proposal" or "Release") *available at* https://www.sec.gov/rules/proposed/2020/33-10814.pdf. We use the terms "funds" and "open-end funds" to refer to mutual funds and exchange-traded funds (ETFs).

[3] We refer to "fund shareholders," "shareholders," "fund investors," and "investors" interchangeably throughout this letter.

In the past 20 years, the internet has transformed and accelerated investors' ability to gather financial information. In 2020, approximately 96 percent of households owning mutual funds had internet access, compared with 68 percent in 2000. The gaps in internet access between younger and older households and between higher- and lower-income households have narrowed, and in 2020, the vast majority of mutual fund–owning households had internet access across each age and income grouping.[4] Internet access coupled with advances in technology permit investors to choose whether to access financial information through computers, tablets, smartphones, or paper versions of documents. They also can choose to engage a financial professional to evaluate this information.

We understand that many funds and financial intermediaries use technology to communicate more effectively with investors and respond to their preferences. They continue to explore additional ways to use technology to further improve those communications. The Commission now has the opportunity similarly to leverage technology to enhance investor disclosure – providing investors with digestible, layered information and choice. A guiding principal should be that investor preferences are honored and facilitated—whether they prefer to read full-length or summary disclosure documents in paper, in electronic format, or receive notice that fund documents are available online.

The Commission's proposal would advance some, but not all, of these goals. We therefore support several elements of the proposal and recommend modifying other aspects. We also strongly encourage the Commission to modernize the ability of funds to deliver information electronically to shareholders ("e-delivery").

The proposal would reform dramatically the mosaic of requirements that govern how funds deliver information to investors. The Institute and its members have endeavored to identify the economic impact, including any cost savings, to inform the Commission's deliberations as it determines how to move forward. This is a complicated and imperfect exercise given the number of interrelated changes that the Commission proposes.

Certain members concluded that the breadth of the changes to the current disclosure system and the significant costs that would be involved to implement them outweigh the anticipated benefits. Their concerns partially were informed by the resources they are dedicating to implementing other recently-adopted rules.[5] These members, while expressing a minority view, strongly prefer that the SEC move forward to facilitate e-delivery, but not adopt other proposed changes (including not eliminating Rule 30e-3).

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[4] *ICI Research Perspective*, "Ownership of Mutual Funds, Shareholder Sentiment, and Use of the Internet, 2020" (November 2020) ("ICI Research Perspective on Shareholder Sentiment"), *available at* https://www.ici.org/pdf/per26-08.pdf.

[5] Just since October 2020, the Commission has adopted three significant rules under the Investment Company Act: the fund of funds rule (Rule 12d1-4), the derivatives rule (Rule 18f-4), and the fair valuation rule (Rule 2a-5).

In the remainder of the letter, we provide detailed recommendations, reflecting the views that most of our members share.

We strongly recommend that the Commission:

- permit funds to e-deliver disclosure documents to fund shareholders while permitting any shareholder to request at any time that the documents be delivered in paper;
- retain Investment Company Act Rule 30e-3 as optional for open-end investment companies; and
- allow funds to satisfy delivery obligations by posting semiannual shareholder reports online.

Each of these recommendations is described more fully below.

We are disappointed that, as part of this overhaul of fund disclosure, the Commission did not propose to modernize the 25-year old guidance that governs electronic delivery.[6] As the Commission continues to consider disclosure reform, we strongly recommend that it allow funds to e-deliver disclosure documents to shareholders while continuing to deliver documents in paper to any shareholder who so requests. Doing so will better satisfy investor preferences and reduce costs for fund shareholders. As the Commission recognizes, "investors have shown a general familiarity with using the internet to find information about a fund" and "many investors indicated that they go to fund or intermediary websites to get information about a fund investment…[and] [m]any investors also expressed a preference for receiving fund disclosure electronically, either through email, mobile application, or website availability."[7]

The Commission proposes to amend Rule 30e-3 so that open-end funds could no longer rely on it. The Commission adopted this rule in 2018 and provided for a two-year transition period. Funds may begin using Rule 30e-3 on January 1, 2021, which rule generally allows funds to satisfy shareholder report transmission requirements by making these reports and other materials available online and providing a notice of availability instead of directly mailing the report (or emailing an electronic version of the report) to shareholders.[8]

We recommend that the SEC retain Rule 30e-3, continuing to permit, but not require, open-end funds to rely on it. A fund manager, as a fiduciary, should be able to evaluate, and determine, the most effective option for transmitting disclosure documents to fund investors, evaluating investor

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[6] *See* Use of Electronic Media for Delivery Purposes, SEC Release No. IC-21399 (Oct. 6, 1995) (providing Commission views on the use of electronic media to deliver information to investors, with a focus on electronic delivery of prospectuses, annual reports, and proxy solicitation materials).

[7] Release at 31.

[8] *See Optional Internet Availability of Investment Company Shareholder Reports,* SEC Release Nos. 33-10506; 34-83380; IC-33115 (June 5, 2018), at 76-78 (regarding the effective date, transition period, and related conditions), *available at* https://www.sec.gov/rules/final/2018/33-10506.pdf.

preference, cost, alternative transmission options, and other relevant factors. Our members have spent a great deal of time and money preparing for the transition to delivering Rule 30e-3 notices to shareholders. They have included disclosure six or more times on shareholder reports and prospectuses informing shareholders of the upcoming change. Further, they spent considerable time educating investors about Rule 30e-3, responding to inquiries, coordinating with intermediary partners, and solving the logistical challenges of respecting investor choice across platforms. Even more importantly, this process has created an expectation amongst investors about how they will receive this information going forward.

We recommend that funds be permitted to satisfy semiannual shareholder report delivery obligations by posting the report online and providing a copy to any shareholder who requests one consistent with his or her preferred manner of receiving information. The recommended approach would be consistent with the Commission's preference for layered disclosure. It also would recognize that the semiannual shareholder report may be less informative to shareholders monitoring their investments than the annual shareholder report.[9] All shareholders would benefit from the associated cost savings.

We strongly support the proposed streamlined shareholder report. It would contain key information in a prescribed order, and some of today's required shareholder report content would be available online in Form N-CSR. ICI recommended that the Commission propose a summary shareholder report, the contents of which are similar in many respects to the Commission's proposed new streamlined shareholder report.[10] Our investor testing of the ICI summary shareholder report prototype indicated that investors would be more likely to read a shorter shareholder report and that such a report can successfully communicate content.[11] That said, we have significant concerns with requiring funds to include the new "Material Fund Changes" section in the annual shareholder report.

Our comments are intended to achieve a balance that permits flexibility for funds to create documents that can vary in length and manner of delivery, while assuring that investors have easy access to additional information. In developing our comments, we focused on maximizing a fund's opportunities to reach and inform investors and not overwhelming them with complex, overly detailed or difficult-to-understand information. We also considered, as best we could, the costs associated with the proposed changes. We found assessing the financial effects of this proposal extremely challenging. We therefore cannot relay our views on several aspects with any

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[9] We note that the semiannual shareholder report covers only six months and is not required to include performance information or a discussion of investment strategies and techniques employed by the fund's adviser.

[10] *See* Letter from Susan Olson, General Counsel, ICI, to Brent J. Fields, Secretary, SEC, (October 24, 2018) ("ICI Retail Investor Experience Letter"), *available at* www.sec.gov/comments/s7-12-18/s71218-4932121-178430.pdf; *see also* ICI Research Perspective on Shareholder Sentiment, *supra*, note 4.

[11] *See* Holden, Seligman, and Schrass, "Mutual Fund Investors' Views on Shareholder Reports: Reactions to a Summary Shareholder Report Prototype" (October 2018), *available at* https://www.ici.org/pdf/ppr_18_summary_shareholder.pdf.

certainty given that there are so many combinations of disclosure formats and delivery mechanisms, and each combination potentially will affect firms differently depending on the characteristics of their shareholder populations, distribution models, and disclosure practices.[12]

I. Background and Executive Summary

Current Disclosure (Type, Frequency) and Manner of Delivery

Most mutual funds and ETFs currently provide a summary prospectus to investors in connection with their initial investment decision and an updated summary prospectus annually to reflect changes. A shareholder also may receive prospectus supplements, or "stickers," during the year to reflect certain changes affecting the fund. In addition, funds provide online more detailed information in the fund's statutory prospectus and Statement of Additional Information ("SAI"), which may be of interest to some of the fund's investors. Funds also transmit to investors semiannual and annual shareholder reports that also are posted online.[13]

Some funds deliver an annual shareholder report and an annual prospectus update at different times, and other funds deliver both documents at the same time. Fund shareholders receive shareholder reports and prospectuses in paper or via email. Shareholders must affirmatively consent to e-delivery of these documents.[14] Funds must deliver the documents in paper to all other shareholders.[15] Beginning on January 1, 2021, funds will have the option to deliver a paper notice in the US mail informing shareholders that a shareholder report is available online.[16]

[12] For example, if the Commission permits funds to transmit documents electronically unless a shareholder requests paper, funds that have larger direct account populations will experience significant cost savings from that one critical change. In comparison, funds with larger broker-sold account populations expect to experience cost savings, but less so because a greater percentage of these investors already have opted into e-delivery. If the Commission eliminates Rule 30e-3, costs may increase, particularly for funds with a larger number of direct and legacy accounts. It is important to keep in mind that shareholders bear the substantial costs associated with creating, printing, and mailing disclosure documents.

[13] *See* Section 30(e) of the Investment Company Act; and Rule 30e-1 under the Investment Company Act. We refer to "annual shareholder reports" and "semiannual shareholder reports," individually and collectively, as "shareholder reports."

[14] Investors who opt for electronic delivery typically receive an email that contains a link to where the materials are available online.

[15] Of course, a fund would determine to whom it must transmit the reports factoring in the SEC's householding requirements, which are another important tool that funds use to sufficiently transmit information to investors in a cost-effective manner.

[16] We understand from members that shareholders receiving documents via e-delivery will not be affected by Rule 30e-3 because, as a general matter, funds will choose to continue to transmit shareholder reports via email to any shareholder that has opted into e-delivery.

Key Comments

Manner of Delivering Fund Disclosure to Shareholders

As described above, the Commission should facilitate e-delivery, allow open-end funds to continue to rely on Rule 30e-3, and permit funds to satisfy their semiannual shareholder report transmission obligations by filing them with the SEC, posting them online, and delivering them upon request to shareholders in a manner consistent with the shareholder's delivery preference (*i.e.,* paper or email).

We support Rule 498B only as an optional rule and recommend limiting its availability to funds that choose not to rely on Rule 30e-3. Some of its proposed provisions present significant issues and thus, as currently drafted, its widespread adoption is highly unlikely. To increase its utility, we recommend that the SEC:

- rename the "Material changes to the fund" section set forth in proposed Rule 498B(c)(2) to "What Has Changed;"
- require that funds mail notices to shareholders in accordance with Item 27A(g) of Form N-1A, subject to our significant recommended changes to that Item; and
- require funds to deliver notice of certain changes "as soon as reasonably practicable but no later than fourteen business days" after the change has occurred.

Litigation Risk

The Commission should include statements in any adopting release that make clear that by adopting new or additional requirements, or permitting or encouraging certain additional disclosures or use of tools (rather than requiring them), it is not intending to change the "total mix of information" doctrine that has successfully protected fund shareholders from bearing the costs associated with defending against meritless litigation.

Content of Disclosure

Streamlined Shareholder Report. We generally support the SEC's proposed streamlined shareholder report. We recommend certain targeted changes to the proposed requirements. The SEC should:

- revise the definition of "appropriate broad-based securities market index" to focus on the "appropriateness" of the benchmark index, which would produce more apt and useful performance comparisons for investors;
- rename proposed Item 27A(g) of Form N-1A entitled "Material Fund Changes" to "What Has Changed" and require funds to briefly describe changes that have occurred since the beginning of the reporting period with respect to which the fund has filed an amendment to its registration statement pursuant to Rule 485(a), which amendment is effective;
- modify the liquidity risk management disclosure item to (i) require funds to provide this liquidity disclosure in the streamlined shareholder report only if they do not (a) meet the

definition of "In-Kind ETF" or "primarily highly liquid fund" under the liquidity rule, or (b) consistently hold a majority of their assets in highly liquid investments; and (ii) simplify the instruction to produce more useful information about a fund's liquidity risk profile;

- exempt funds offered exclusively to other funds from the obligation to prepare and transmit shareholder reports; and
- permit all of the fund complex's variable annuity funds, target date funds, target risk funds, money market funds, and state tax-exempt funds respectively to be bundled in a single shareholder report.

Proposed Prospectus Disclosure Changes. We support some, but not all, of the proposed disclosure changes as described below.

- We strongly oppose the proposed fee summary and recommend that the SEC retain the existing fee table as Item 3 of Form N-1A.
- We recommend the SEC test the proposed fee table terminology changes with shareholders before proceeding but we also recommend retaining the existing terminology to describe fee waivers, distribution fees and redemption fees.
- We support the proposed approach for disclosing acquired fund fees and expenses, or AFFE, but we also recommend excluding business development companies, or BDCs, from the definition of acquired funds.
- We recommend excluding performance-related expenses such as interest expense on borrowings from the fee table expense ratio.
- We strongly recommend retaining the current, principles-based approach to risk disclosure rather than requiring funds to disclose principal risks in order of importance.
- We strongly oppose a requirement that funds apply the proposed 10 percent test approach in the first instance to determine if a risk is a principal risk in place of today's principles-based approach to risk disclosure.
- We strongly recommend permitting funds to list principal risks in alphabetical order.

<u>Miscellaneous Comments</u>

- The SEC should maintain its current advertising regulatory framework rather than partially duplicating the Financial Industry Regulatory Authority, or FINRA, requirements (which have provisions related to fees and expenses in retail communications) in SEC rules.
- The SEC should permit funds to disclose in each shareholder report the website address where shareholders can find information about the sources of distributions paid, in lieu of requiring a separate written notice to accompany the distribution.
- The SEC should lengthen the compliance period from 18 to 24 months.

II. The Commission Should Facilitate Funds' Use of E-Delivery and Retain Rule 30e-3

The Commission Should Facilitate Electronic Delivery of Information to Shareholders

The Commission points out that shareholders affirmatively must elect electronic delivery of fund disclosure materials and when they do, they typically receive an email that contains a link to where the materials are available online.[17] The Commission asks what steps it could take to encourage funds to make fuller use of innovative technology to enable more interactive, user-friendly annual reports. We strongly recommend that the Commission do so by making electronic delivery the default method for communicating with investors (while still allowing investors to opt for paper on an *ad hoc* or ongoing basis). We also strongly recommend that the Commission allow funds to satisfy federal securities law obligations by providing access to additional information through smartphone applications. Given the rapid growth in the use of smartphones and other mobile devices, some investors may be more apt to access information on smartphone applications or "apps" than a website. Therefore, the Commission should consider allowing funds to satisfy federal securities law obligations by providing access to additional information through an app in addition to websites or other means.

We recently submitted a comprehensive letter to the Commission explaining the benefits of electronic delivery for fund investors and why the time has come for facilitating the use of electronic delivery. We also detailed key results of a July 2020 survey regarding ICI members' experience with electronically delivering regulatory and other documents to direct-at-fund shareholders. We summarize the points made in that letter here.[18]

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[17] Release at notes 21 and 327.

[18] *See* Letter to Dalia Blass, Director, Division of Investment Management, US Securities and Exchange Commission from Dorothy M. Donohue, Deputy General Counsel – Securities Regulation, Sarah Holden, Senior Director, Retirement & Investor Research, and Joanne Kane, Senior Director, Operations & Transfer Agency, Investment Company Institute, dated September 10, 2020 ("ICI 2020 E-Delivery Letter I"), *available at* https://www.sec.gov/comments/265-33/26533-7964920-224992.pdf for complete survey results. ICI and its members long have recognized the benefits of electronic delivery. *See, e.g.*, Letter from Paul Schott Stevens, President and CEO, ICI, to Brent J. Fields, Secretary, SEC (March 14, 2016), *available at* https://www.sec.gov/comments/s7-08-15/s70815-581.pdf; Letter from David M. Abbey, Deputy General Counsel—Retirement Security, ICI and Doug Fisher, Director of Retirement Policy, American Retirement Association, to Preston Rutledge, Assistant Secretary of Employee Benefits Security Administration, Department of Labor (April 30, 2018), *available at* https://www.ici.org/pdf/18_ici_ara_edelivery_ltr_attachment.pdf, transmitting Peter Swire and DeBrae Kennedy-Mayo, *2018 Update to Delivering ERISA Disclosure for Defined Contribution Plans: Why the Time Has Come to Prefer Electronic Delivery*, *available at* http://peterswire.net/wp-content/uploads/2018-Update-to-Delivering-ERISA-Disclosure-for-DC-Plans-002.pdf. *See also* Letter from David M. Abbey, Deputy General Counsel—Retirement Security, ICI and Doug Fisher, Director of Retirement Policy, American Retirement Association, to Preston Rutledge, Assistant Secretary of EBSA, Department of Labor (September 25, 2018), *available at* https://www.ici.org/pdf/31411a.pdf.

Making electronic delivery the default method for communicating with investors (while still allowing investors to opt for paper) will:

- facilitate positive investor engagement, allowing immediate interaction with shareholders and facilitating a layered approach to disclosure;
- enhance the effectiveness of investor communications, particularly for individuals with disabilities or for whom English is not the primary language;
- allow funds to better satisfy investor preferences; and
- reduce the environmental impact of tons of discarded paper every year.

Further, given the nearly universal access to the internet and broadband, the time has come for electronic delivery to be the default manner of delivery for all fund documents. In fact, data regarding the US population indicate that:

- access to broadband internet or high-speed mobile LTE services is nearly universal, regardless of urban or rural location;
- adults report high rates of internet use, across urban and rural locations;
- the federal government increasingly relies on electronic delivery for the communication of important information;
- mutual fund–owning households—the largest segment of the population investing in registered investment companies—have even higher rates of internet access; and
- high-speed or broadband internet is not necessary for downloading and viewing typical investor disclosures.

Finally, key survey results clearly demonstrate that the time has come for the SEC to act. These data suggest an ability for fund companies and a willingness of fund shareholders to engage electronically. For example:

- the vast majority (96 percent) of fund-company respondents offer e-delivery of investor materials;
- a majority of direct-at-fund accounts with email addresses opted into e-delivery of several important documents:
  - 57 percent of direct-at-fund accounts with email addresses opted into e-delivery of prospectuses and, prospectus supplements, and 57 percent did so for annual and semiannual shareholder reports;
  - 61 percent of direct-at-fund accounts with email addresses opted into e-delivery of account statements, 62 percent did so for daily confirmation statements, and 51 percent did so for tax forms; and
  - 24 percent of respondents reported a positive spike in requests for e-delivery from direct-at-fund accounts since the beginning of the COVID-19 pandemic with two of those experiencing an uptick of 17 percent.

Others have recognized recently that the time has come to change the default to electronic delivery. For example, Chairman Clayton recommended making it easier for funds to deliver

disclosure electronically to their shareholders. At a recent Asset Management Advisory Committee, he stated that:

> [l]ike other stress tests, planned and unplanned, the test imposed by the effects of COVID-19 has provided lessons and insights to the Commission and to market participants alike. Take, for example, electronic delivery of required regulatory documents. The Commission last comprehensively addressed digital delivery in guidance issued over 20 years ago, and has discussed plans to revisit that guidance. Among the pandemic's most obvious disruptions were those challenging firms' ability to deliver paper documents to investors....Looking back at that period, the importance of electronic delivery is clear, and I believe the Commission should consider how to best and promptly update our guidance to make it easier for funds, advisers and investors to use electronic delivery, while ensuring that any investor who wants paper delivery remains fully able to receive it....[O]ur efforts to meet the challenges presented by COVID-19 have unquestionably demonstrated that our regulations should not cling to the mails and paper as the default or preferred paradigm for communications.[19]

Similarly, the Commission's Asset Management Advisory Committee unanimously voted to recommend that the SEC:

- permit firms to use an investor's digital address, such as an email or smart phone telephone number, as the primary address when delivering regulatory documents; and
- incorporate appropriate investor protection principles that include notice, choice and safeguards.[20]

Further, we recently transmitted a letter to SEC Chairman Clayton repeating our strong support for funds being permitted to move from an opt-in to an opt-out model for e-delivering disclosure documents to investors.[21] The letter responded to staff observations, including that it might be possible for sensitive documents like account statements and tax forms that have personal information to be sent to the wrong email address or an email address that someone other than the intended recipient may access. We explained that this concern is misplaced for a few reasons.

First, virtually no funds print a shareholder's Social Security number or date of birth on an account statement. Funds only ask for this information in connection with opening an account. In

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[19] *See* Chairman Clayton, *Opening Remarks at the November 5, 2020 Asset Management Advisory Committee*, *available at* https://www.sec.gov/news/public-statement/clayton-amac-2020-11-05.

[20] *See, e.g., US Securities and Exchange Commission Asset Management Advisory Committee Preliminary Recommendations of Operations Panel Regarding COVID-19 Operational Issues* (November 5, 2020), *available at* https://www.sec.gov/spotlight/amac/operational-issues-amac-recommendations-final-110520.pdf

[21] See Letter from Eric J. Pan, President & CEO, Investment Company Institute, to the Honorable Jay Clayton, Chairman, SEC (December 10, 2020) ("ICI 2020 E-Delivery Letter II"), *available at* https://www.ici.org/pdf/20_ltr_secedelivery.pdf.

that instance, the information is included on the initial account opening confirmation to assure there are no typographical errors. After that, neither a shareholder's full Social Security number nor date of birth ever appear on a statement again. On tax forms, all, or a portion, of the Social Security number is masked. This protocol has been in place for many years.

In addition, fund communications, such as account statements and tax forms, are never emailed directly to a shareholder. Rather, the fund's transfer agent sends an email which includes a link to the fund's website where the statement or tax form is located behind a secure firewall and not accessible to the general public. To access the document, a shareholder must log into his or her account using a unique username and password. That means that even if the email was sent to the wrong person, the email recipient also must have access to the shareholder's login credentials to view the statement or tax form.

We also heard concern that funds could use an incorrect email address for a shareholder. This is unlikely to occur because the shareholder provides the fund with his or her email address in the first instance. If an email is undeliverable to a shareholder, the email bounces back, and the fund attempts to obtain a new email address from the shareholder. If unsuccessful in obtaining a new email address, the fund then will communicate with that shareholder via paper.

We therefore believe that the Commission has an exceptionally strong record on which to take action to modernize electronic delivery requirements for the benefit of fund shareholders.

<u>The Commission Should Retain Rule 30e-3</u>

Rule 30e-3 generally permits funds to satisfy shareholder report transmission requirements by making these reports and other materials available online or in paper by telephone request and providing a notice of this availability instead of directly mailing the report (or emailing the report) to shareholders. The Commission adopted this rule in 2018 and provided for a two-year transition period. Most funds may begin using Rule 30e-3 on January 1, 2021. The Commission now proposes to withdraw the rule.

We strongly recommend that the SEC retain Rule 30e-3 so that funds may, but are not required to, rely on it. Our members have informed us that they have dedicated many resources to preparing for the transition to delivering Rule 30e-3 notices to shareholders, including through disclosure on shareholder reports and prospectuses informing shareholders of the upcoming change in six or more notices over the past two years. They have been educating investors about 30e-3, responding to inquiries, coordinating with intermediary partners, and solving the logistical challenges of respecting investor choice across platforms. Even more importantly, this process has created an expectation amongst investors about how they will receive this information going forward.[22]

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[22] ICI has held biweekly member calls over the past two years, typically attended by dozens of members, which further illustrates the industry's commitment to getting this right for the benefit of investors. Our members that

The majority of ICI members plan to begin relying on Rule 30e-3 in January 2021. By the time the Commission analyzes the comments on the instant disclosure reform proposal, adopts a final rule, and any compliance period has elapsed, shareholders will have received Rule 30e-3 notices for approximately three years (*i.e.,* if the Commission adopts a new disclosure reform package by January 2022 with a two-year compliance period).[23]

Also, a recent ICI survey found that only ½ of one percent of direct-at-fund accounts asked for paper shareholder reports in response to fund requests related to complying with Rule 30e-3. This seems to strongly suggest that Rule 30e-3 satisfies most fund shareholders' disclosure preferences.[24]

The Commission has proposed that Rule 30e-3 be amended to eliminate the ability of funds registered on Form N-1A to rely on the Rule to satisfy their obligations to deliver shareholder reports to record holders under Rule 30e-1. For underlying funds of variable insurance products,[25] this would mean that they would not be able to rely on Rule 30e-3 to satisfy their obligations under Rule 30e-1 to deliver shareholder reports to the insurance company separate accounts or other record holders. As described above, the Commission should not amend Rule 30e-3. All funds registered on Form N-1A should continue to be able to rely on the Rule for delivery of shareholder reports to their record owners.

Delivery of fund shareholder reports to contract holders, however, is the responsibility of insurance company separate accounts under Rule 30e-2. The proposal would not amend Rule 30e-3 to exclude insurance company separate accounts, nor would it amend Rule 30e-2 in any respect. Accordingly, by the terms of the proposal, the amendments would not affect the ability of insurance company separate accounts to rely on Rule 30e-3 in order to satisfy their Rule 30e-2 obligations to deliver fund reports to contract holders.

The continued ability of insurance companies to rely on Rule 30e-3 for delivery of fund reports to contract holders is of vital importance to underlying funds, because fund participation

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predominantly distribute their funds directly to investors and offer their funds through insurance company separate accounts particularly favor retaining the option to use Rule 30e-3. This is not surprising, since, unlike intermediary-distributed funds, these funds do not pay the NYSE processing fees associated with delivering Rule 30e-3 notices.

[23] At a minimum, but clearly not the preferred path forward, we recommend that the Commission use data collected over this three-year (or longer) period to bolster the empirical basis for withdrawing Rule 30e-3. The Institute would be ready assist with any such effort. *See, e.g.,* Release at 359-360 (where the Commission estimates that withdrawing the availability of Rule 30e-3 for open-end funds will cause funds in the aggregate to forego $221 million in cost savings.)

[24] ICI survey respondents manage approximately $18 trillion of mutual fund assets, representing approximately 85 percent of industry mutual fund assets at the end of June 2020. We provided the SEC with the complete survey results in September. *See* ICI 2020 E-Delivery Letter I, *supra*, note 18.

[25] "Underlying funds" refers to funds serving as underlying investment options under a variable annuity or variable life insurance contracts.

agreements between insurance companies and underlying funds typically require substantial operational assistance and cost sharing from underlying funds in fulfilling insurance companies' fund report delivery obligations. Accordingly, if the Commission, despite our recommendation, amends Rule 30e-3 to exclude funds registered on Form N-1A, we request that the Commission clarify in the adopting release that this does not in any way affect the ability of insurance company separate accounts to rely on Rule 30e-3 for delivery of fund reports to contract holders under Rule 30e-2, and that they may continue to do so.

III. The Commission Should Permit Funds to Post Semiannual Shareholder Reports Online

The proposal would require funds to transmit semiannual shareholder reports to investors consistent with their delivery preference (*i.e.,* in paper or electronically), just as funds do today. The Release indicates that the Commission considered alternatives to requiring transmission of semiannual shareholder reports, including by allowing a fund to satisfy the transmission requirement by filing certain information on Form N-CSR, or updating information posted to its website.

We recommend that the Commission permit funds to fulfill their semiannual shareholder report transmission obligation by making the semiannual shareholder report available online provided that the fund:

- posts the semiannual shareholder report to its website and files the semiannual shareholder report with the SEC on Form N-CSR not more than 70 days after the semiannual period end;[26]
- includes disclosure in the preceding annual shareholder report indicating that a semiannual report covering the ensuing six-month period will be made available on the fund's website no later than [DATE] and that shareholders may obtain a paper copy of the semiannual shareholder report free of charge by contacting the fund at [PHONE NUMBER AND WEBSITE ADDRESS]; and
- sends the semiannual shareholder report to any shareholder requesting a paper copy upon request free of charge within a reasonably practicable period of time, but in no event later than five business days after receiving the request.[27]

The recommended approach would be consistent with the Commission's preference for layered disclosure. It also would recognize that the semiannual shareholder report may be less informative to shareholders monitoring their investments than the annual shareholder report. We point out, in particular, that the semiannual shareholder report covers only six months and is not

[26] We recommend that funds be permitted to extend the 70-day period by up to 15 days provided the fund makes a Rule 12b-25 filing.

[27] If funds would no longer be required to transmit semiannual reports, they would not print the reports in advance of requests. In the event that a substantial number of investors request the reports, three business days is simply not a sufficient amount of time to deliver them, particularly for intermediary-sold funds.

required to include performance information or a discussion of investment strategies and techniques that a fund adviser employs. All shareholders would benefit from the associated cost savings.

IV. The Commission Should Consider the Potential Effect on Litigation Risk from Disclosure Reform

Funds, along with their directors, officers and advisers, frequently face the threat of shareholder litigation under the securities laws based on allegedly misleading disclosures.[28] Many of these suits, which are primarily lawyer-driven, are meritless and serve only as a distraction and a drain on resources that would otherwise be devoted to fund management and shareholder services. The proposal thus warrants consideration from the perspective of its potential effect on shareholder litigation claims—namely, whether the proposed changes could have the unintended consequence of creating additional shareholder litigation risk for funds and other potential defendants based on the *location and ordering* of information within disclosures, not on the substance of the information.

As an initial matter, we do not believe that the proposal will increase the likelihood of funds and other defendants being found liable on shareholder claims under the federal securities laws. The modifications do not impose new substantive disclosure requirements in areas that are the typical focus of litigation claims, such as investment objectives and principal risks.[29] Since the proposed amendments would not meaningfully change the substance of the information required to be disclosed, they likewise should not meaningfully increase the chance of a material misstatement or omission occurring in fund disclosures.[30]

That said, we believe that certain of the proposed amendments could open the door unnecessarily to shareholder plaintiffs asserting new meritless arguments based solely on the location and ordering of information within disclosures. Experience shows that plaintiffs' counsel in securities actions often assert that a disclosure is misleading because certain information about a fund's features or risks—even though disclosed—was not prominent enough within the fund's disclosures. Such arguments assert that investors are misled into viewing information as less

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[28] These claims are primarily asserted pursuant to the provisions of the securities laws providing direct private rights of action to shareholders claiming to have purchased or sold fund shares pursuant to materially misleading fund disclosures: (i) Sections 11 and 12 of the Securities Act of 1933 ("Securities Act"); (ii) Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), and Rule 10b-5 thereunder; and (iii) the corresponding "control person" provisions in each statute, *i.e.*, Section 15 of the Securities Act and Section 20 of the Exchange Act.

[29] As the Commission notes: "[u]nder the proposal, the amounts and types of fund information would remain largely unchanged. However, information that is of interest only to some shareholders, or information that we believe generally is less useful for purposes of assessing and monitoring an ongoing investment, would be available online and delivered upon request to fund shareholders who want additional information." Release at 11.

[30] The proposed amendments include certain new substantive disclosure requirements regarding fees and expenses. Release at 11. Disclosures in these areas, however, are not likely to be the focus of shareholder litigation claims, which must be based on alleged material disclosure misstatements or omissions that can be causally linked to a diminution in share value.

important simply by *where* it is found within the disclosure—*e.g.*, in the middle or latter pages of a prospectus, near the end of a list of risk disclosures, or within the SAI rather than in the statutory prospectus.[31]

These location-based arguments are meritless, and courts correctly applying existing precedent typically reject them. Nevertheless, plaintiffs continue to assert these location-based arguments, and funds and other defendants are forced to counter them. Given that the proposed amendments would alter *where* certain information is found within fund disclosures, plaintiffs could attempt to rely on the new requirements as support for location-based arguments in shareholder litigation. We therefore urge the Commission to make clear in any adopting release or other guidance that the proposed disclosure amendments are not intended to change the "total mix of information" available to shareholders or affect how courts should assess fund disclosures for purposes of shareholder litigation.

The "Total Mix of Information" Doctrine

In determining whether a disclosure challenged in shareholder litigation is materially misleading, a court must look to the "total mix of information" available to the shareholder.[32] When applied to funds, the "total mix of information" doctrine prevents plaintiffs from focusing a court's attention on a particular disclosure document or portion of such a document in isolation. Rather, when assessing whether a challenged fund disclosure could have misled a reasonable investor, the court must not only review that document in its entirety but must also read that document in light of all other required fund disclosures reasonably available to the investor. In the fund context, this "total mix" includes, among other things, the registration statement, statutory prospectus, SAI and shareholder reports.[33]

Shareholder plaintiffs accordingly are deemed to be on notice for all of the information in these required fund disclosures, including those that are not required to be uniformly delivered to investors but are otherwise readily available to them (such as the SAI). Therefore, for example, a shareholder cannot successfully claim to have been misled about the risks posed by a fund's stated investment strategy when the very risks that came to fruition were described elsewhere in the prospectus and/or in the SAI.[34] Nor can the shareholder claim that a prospectus' description

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[31] *See, e.g.*, *Emerson v. Mut. Fund Series Tr.*, 393 F. Supp. 3d 220, 245-50 (E.D.N.Y. 2019).

[32] *See Basic, Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988) ("[T]here must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available.").

[33] *See, e.g.*, *In re Morgan Stanley Info. Fund Secs. Litig.*, 592 F.3d 347, 365-66 (2d Cir. 2010) ("When analyzing offering materials for compliance with the securities laws, we review the documents holistically and in their entirety."); *Hunt v. Alliance N. Am. Gov't Income Trust, Inc.*, 159 F.3d 723, 730-31 (2d Cir. 1998); *Emerson*, 393 F. Supp. 3d at 245-50; *White v. Melton*, 757 F. Supp. 267, 272 (S.D.N.Y. 1991).

[34] *See, e.g.*, *Morgan Stanley,* 592 F.3d at 365-66; *Press v. Quick & Reilly, Inc.*, 218 F.3d 121, 129–31 (2d Cir. 2000) (explaining the Second Circuit "ha[s] consistently recognized that publicly filed information may be considered when evaluating a claim of securities fraud" and finding disclosures in both the prospectus and SAI among the total mix of information "reasonably available to the shareholders"); *Hunt v. Alliance N. Am. Gov't Income Trust, Inc.*, 159 F.3d

of a given risk was missing or incomplete, if the allegedly omitted information is set forth in the SAI or a shareholder report.[35] And while certain fund disclosures are permitted to expressly incorporate others by reference, there is no requirement for purposes of shareholder litigation that material be formally incorporated by reference into a challenged disclosure in order to be part of the "total mix of information" available to investors.[36]

There are four aspects of the proposed amendments in particular that may give rise to meritless arguments based solely on the location or ordering of information within disclosures—*i.e.*, that a disclosure is misleading because certain information about a fund's features or risks, even though disclosed, was not prominent enough within the fund's disclosures. We are referring to the proposed amendments that would:

- create a new (optional) Rule 498B, under which existing shareholders would no longer receive an updated annual prospectus each year;
- require that only principal risks be described in the summary or statutory prospectus, with non-principal risks allowed to be set forth in the SAI;
- require that funds list principal risks in the summary portion of the statutory prospectus in the order of importance, with the most significant risks appearing first; and
- move information from the current shareholder report to Form N-CSR.

723, 730-31 (2d Cir. 1998); *Emerson*, 393 F. Supp. 3d at 245-50; *White v. Melton*, 757 F. Supp. 267, 272 (S.D.N.Y. 1991); *In re Direxion Shares ETF Tr.*, 279 F.R.D. 221, 225 (S.D.N.Y. 2012) (assessing disclosures in the registration statement, prospectus, and SAI together because the SAI is legally part of the prospectus that incorporates it by reference).

[35] *See, e.g.*, *Press*, 218 F.3d at 129–31. Indeed, if a fund and its sponsors could be faulted for including more detailed information in the SAI than in the prospectus, it would defeat the very purpose behind Form N-1A's layered structure—a readable plain-English prospectus providing certain key information in a clear and concise format, supplemented by additional material in the SAI for investors interested in further detail. *See Morgan Stanley,* 592 F.3d at 352 n.2 (explaining that Form N-1A "calls for a streamlined, simplified prospectus and a Statement of Additional Information, or SAI,. . . . [that] offer[s] issuers the opportunity to provide more detailed discussions of matters required to be in the prospectus" (internal quotes and citations omitted)); *see also La Pietra v. RREEF Am., L.L.C.*, 738 F. Supp. 2d 432, 441 (S.D.N.Y. 2010) (finding prospectuses that pre-dated the class period by years to be part of the total mix of information and explaining "while a reasonable investor certainly should not be expected to pore through every filing in the life of a years-old fund, it is reasonable to hold such an investor responsible for knowledge of the disclosures in a fund's prospectus" where "[i]n today's world it is unrealistic to argue that documents available on the SEC website . . . are not readily accessible to the investing public").

[36] In the adopting release for the 2009 amendments to Form N-1A, the Commission stated its view that funds that provided investors with a summary prospectus in good faith compliance with Rule 498 would be protected from liability under the Securities Act against a claim that the summary prospectus did not include information that is disclosed in the fund's statutory prospectus, "whether or not the fund incorporates the statutory prospectus by reference into the Summary Prospectus." *Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies*, SEC Release Nos. 33-8998; IC-28584 (Jan. 13, 2009) ("Summary Prospectus Release"), *available at* https://www.sec.gov/rules/final/2009/33-8998.pdf. Widespread industry use of the summary prospectus likely would not have occurred in the absence of the Commission statement.

V. The Commission Should Modify Proposed Rule 498B

The Commission proposes creating a new optional Rule 498B. Funds choosing to rely on it would provide investors with a prospectus in connection with their initial fund investment but would not be required to provide existing shareholders with annual prospectus updates. The Commission reasons that prospectus updates would be unnecessary because, among other things, the fund's current prospectus would be available online, shareholders would receive tailored annual shareholder reports with a summary of material fund changes, and shareholders would receive timely notifications regarding material fund changes as they occur.

We support funds being permitted to choose to rely on Rule 498B but underscore that using it must be optional.[37] We also recommend that funds choosing to rely on Rule 498B not be permitted to simultaneously rely on Rule 30e-3. This dichotomy helps assure that investors are provided with appropriate disclosure. If a fund were permitted to rely on both Rule 30e-3 and proposed Rule 498B, its shareholders only would receive only a Rule 30e-3 notice.[38] The Commission recognizes this, stating that:

> if a fund were permitted to rely upon both Rule 30e-3 and proposed Rule 498B, shareholders in such a fund would no longer directly receive shareholder reports or annual prospectus updates, and thus would not be sent any periodic regulatory disclosure documents.[39]

We recommend that the Commission permit funds choosing to rely on Rule 498B to transmit an annual shareholder report that includes a section labeled "What Has Changed." This section would describe changes that have occurred since the last shareholder report.[40] And for purposes of determining *when* to mail notices to shareholders during the year, we recommend amending Rule 498B(c)(2) as follows:

> *What Has Changed*. If a Fund must include an item in its annual report in accordance with Item 27A(g) of Form N-1A, it also must provide shareholders with notice of that change....

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[37] We also support the conditions related to website availability and other aspects of ease of access for shareholders in funds that choose to use proposed Rule 498B, which track the conditions for funds' use of summary prospectuses. As Form N-3 registrant disclosures generally have been tailored to be in a similar order and focus as retail fund prospectuses, Form N-3 filers should be permitted to follow the disclosure regime adopted for Form N-1A filers to promote comparability.

[38] Generally, any shareholders choosing e-delivery easily could open the email from the fund notifying him or her that a new shareholder report is available and click on the link to view the shareholder report.

[39] Release at 48.

[40] The content would align with our recommendations with respect to annual shareholder reports. Funds including this section in their annual reports would be required to include such changes occurring during the fiscal year.

If Rule 498B is adopted as proposed, it is possible that funds that currently use a summary prospectus may have reservations about relying on Rule 498B, given the prospect of the significant uncertainty surrounding costs associated with having to send notifications of material changes as they occur to a fund's entire shareholder base. The cost will vary by fund and depend on materiality triggers and timing of these changes.

Accordingly, some funds that use a summary prospectus could, in fact, reasonably determine that the current delivery regime of sending an annual summary prospectus update each year to existing shareholders provides more certainty in terms of overall costs than would relying on Rule 498B.

Potential Liability Implications

In the event Rule 498B is adopted, and regardless of how funds are required to determine which changes to include in the annual shareholder report and in notice mailings, there presumably will be certain changes in a fund's prospectus year-over-year that are not deemed sufficiently material to be included in the annual shareholder report. For example, fund risk disclosures are often subject to regular review and revision in the annual prospectus, perhaps reflecting enhancements in light of evolving disclosure practices, market conditions or major economic events. Such enhancements may not be considered significant enough to be included in the annual report update sent to current shareholders but may nevertheless be relevant to a risk that could come to fruition and negatively affect fund performance. In the event that shareholder litigation ensued, plaintiffs could be expected to allege that the risk was "minimized" and the revised disclosure was "buried" because it was only included in an updated prospectus available online rather than being included in the annual shareholder report sent to current shareholders.

The Commission's goal of streamlining and layering the information that is provided to shareholders should not come at the expense of funds and others facing such meritless arguments in shareholder litigation. We therefore recommend that new Rule 498B, if adopted, be accompanied by Commission guidance clarifying that it is not intended to alter the total mix of information available to shareholders or otherwise affect how courts should assess fund disclosures for purposes of shareholder litigation. In particular, all risk disclosures set forth in a fund's current prospectus and SAI should be considered part of the total mix of information available to investors, regardless of whether the disclosures are included or discussed in the annual or semiannual report delivered to existing shareholders.

Notice of Material Changes

Proposed Rule 498B would require funds to provide shareholders notice within three business days of any material change with respect to any of the topics described in proposed Item 27A(g) of Form N-1A with respect to which the fund has made a post-effective amendment filing or a prospectus supplement filing. The proposed rule would not specify the form of this notice. A fund could satisfy this requirement, for example, by sending existing shareholders the prospectus

supplement filed with the Commission, an amended prospectus which reflects the material change, or another document that describes the change.[41]

In addition to the substantive concerns that we have with Rule 498B(c)(2) (described above) and Item 27A(g) (described below), we have concerns with this provision's timing requirements. The proposed three-business-day period starts upon either the effective date of the post-effective amendment filing or the filing date of the prospectus supplement (as the case may be). Mailing a document to a fund's *entire* shareholder base simply is not possible within that short of a timeframe.

Practically speaking, vendors conducting such a large volume mailing need approximately three business days to gather underlying beneficial owner contact information from intermediaries. After that, the vendors take approximately 10 business days to complete the mailing. During that time, they prepare the mailings, including determining how to manage each of their clients' jobs in a timely manner and scheduling each client's job using the appropriate equipment.[42] (Vendors typically manage multiple jobs at any given time.) Additionally, the COVID-19 pandemic has increased the time vendors need, given that physical distancing requirements limit the number of operators per machine and increased employee absences because of illness.[43]

We therefore recommend that any final rule require funds to deliver notice of material changes "as soon as reasonably practicable but in no event longer than fourteen business days."

If the Commission adopts these changes, we recommend accompanying the changes with Commission guidance clarifying that the amendment is not intended to alter the total mix of information available to shareholders or otherwise affect how courts should assess fund disclosures for purposes of shareholder litigation.

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[41] While this will permit funds to transmit the information without having to pay the NYSE's fees regarding mailing of so-called "notices," funds still may have to pay interim mailing fees under the NYSE fee schedule. *See* Letter from Susan Olson, General Counsel, ICI, to Brent J. Fields, Secretary, SEC (Oct. 31, 2018) ("ICI Processing Fee Letter"), *available at* www.sec.gov/comments/s7-13-18/s71318-4594882-176335.pdf for a more detailed explanation of how processing fees work, the applicable legal standards, and ICI's recommended reforms. Additional information about processing fees appears on ICI's Processing Fees Resource Center, *available at* https://www.ici.org/pfrc.

[42] Mailing jobs are carefully choreographed in advance to avoid as much as idle machine time as possible. Given this, the necessary equipment may not be available on demand or immediately for a particular mailing.

[43] Vendors may run the mail machines at reduced speeds to accommodate the lower number of operators per machine, which increases the time it takes to complete a particular mailing job.

VI. Selected Comments on Proposed Changes to Shareholder Reports, Form N-CSR Filings, and Website Availability Requirements

We support much of the Commission's proposed design and content of funds' annual and semiannual shareholder reports.[44] In Appendix B, we express support or recommend minor improvements for many items on an item-by-item basis, generally following the same order as the proposal.

We also provide immediately below recommendations that could make the new streamlined shareholder report even more useful for investors.

Performance Line Graph and Index Comparison

The SEC has proposed several amendments to Form N-1A related to performance presentations, which would (i) clarify how a multiclass fund must select a share class for purposes of the line graph performance presentation in shareholder reports; (ii) limit such line graph presentations to a 10-year period; and (iii) amend the definition of "broad-based securities market index" for purposes of both the line graph and prospectus performance presentations. We discuss each below.

Share Class Selection Clarification for Multiclass Funds

The proposal would add an instruction related to share class selection in line graph presentations for multiclass funds.[45] We support this change. Multiclass funds already follow this instruction when presenting performance in bar chart form in their prospectuses. And the instruction provides funds some presentation flexibility, while generally favoring performance presentations covering longer periods.

Ten-Year Limit on Line Graph Presentations

The proposal would remove an instruction that currently allows the performance line graph to cover periods longer than the past 10 fiscal years. The SEC explains that this flexibility may reduce comparability that diminishes the benefits of the line graph and may result in performance presentations that could give rise to unrealistic investor expectations (*e.g.*, substantially larger ending values (in dollars) over longer periods).[46]

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[44] Proposed Item 27A of Form N-1A.

[45] Proposed Instruction 13(a) to Item 27A(d)(2). The instruction would provide a multiclass fund with discretion as to which share class to include (*e.g.*, the oldest class, the class with the greatest net assets), provided that the fund: (i) selects the class with 10 or more years of annual returns if other classes have fewer than 10 years of annual returns; and (ii) selects the class with the longest period of annual returns when the classes all have fewer than 10 years of annual returns. (iii) explains in a footnote the reasons for selecting a different class from that in the prior annual shareholder report, if applicable.

[46] Release at 97.

We recommend that funds continue to be permitted (but not required) to show performance extending beyond 10 years. A longer time period is *more* likely to show the potential short-term variability of fund returns and thus highlight the potential risks of investing. To illustrate, a US large cap equity fund showing performance from January 1, 2009, through December 31, 2018, likely showed impressive growth with relatively minor declines over that period. Yet extending the line graph to include 2008 would capture a significant decline and thus the fund's potential volatility.

Also, longer track records are more likely to show secular trends in fund performance, which is particularly important information for long-term investors (*e.g.*, the effects of compound returns over long periods). To the extent that the SEC prefers standardized performance information focused on shorter and more recent intervals, funds with track records exceeding 10 years could be required to provide returns for their 1-, 5-, and 10-year periods in a table that accompanies the line graph. The two performance presentations complement one another effectively in this way, and do not overemphasize long-term performance or minimize potential volatility (the bar chart performance presentation in the prospectus offers yet another graphical way for investors to understand a fund's year-to-year performance volatility).[47]

"Broad-Based Securities Market Index" Definition

Currently, an open-end fund must compare its performance to that of an "appropriate broad-based securities market index" in its prospectus and annual shareholder report.[48] The proposal would add the following to this defined term:

> A "broad-based index" is an index that represents the overall applicable domestic or international equity or debt markets, as appropriate.

The Release explains that "[w]hile indexes based on narrow segments of the market may be useful for comparison purposes, we believe that all funds should compare their performance to the overall market."[49]

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[47] Consistent with the current Form N-1A instruction (Instruction 1(d) to Item 27(b)(7)(ii)(A) of Form N-1A), we support requiring funds that have minimum investments that exceed $10,000 to use their higher investment minimums for purposes of the line graph presentation.

[48] Items 4(b)(2)(iii) and 27(b)(7)(ii)(A) of Form N-1A. The form defines "appropriate broad-based securities market index" in relevant part as "one that is administered by an organization that is not an affiliated person of the Fund, its investment adviser, or principal underwriter, unless the index is widely recognized and used." These funds also may compare their performance to one or more "additional indexes" in their prospectuses and shareholder reports. Instruction 6 to Item 27(b)(7) of Form N-1A states that these would be indexes other than the required broad-based index, and may include "other more narrowly based indexes that reflect the market sectors in which the Fund invests" or "an additional broad-based index, or to a non-securities index (*e.g.*, the Consumer Price Index), so long as the comparison is not misleading."

[49] Release at 98.

Performance comparisons are important to investors. According to ICI's latest survey on the subject, when mutual fund–owning households were asked about the information they consider when choosing a mutual fund, 89 percent indicated that they considered a fund's performance compared with an index, with 37 percent saying this benchmarking was very important when making their purchase decision.[50] Thus, any regulatory requirements should foster appropriate "apples-to-apples" comparisons.

We believe the definition of "appropriate broad-based securities market index"—in both its current form and as proposed to be amended—is unduly narrow; in some cases creates potentially confusing and misleading performance presentations; distorts competition in the index market; and may add unnecessary costs. We explain these concerns below and recommend improvements to the performance comparison requirements.

The SEC's requirement includes two terms that are at times in conflict—simply put, a "broad-based" index will not necessarily be an "appropriate" index for purposes of measuring a fund's performance. The proposing release recognizes that "the use of [broad-based] market indexes…may be less effective in helping shareholders understand the fund's performance and risks."[51] More than merely being "less effective," in some cases, the use of a broad-based index (as the SEC contemplates) could produce misleading performance presentations.

By contrast, index selection based entirely on "appropriateness" (without also needing to satisfy a potentially competing "broad-based" requirement) will produce more useful comparative information for investors. If a fund is not seeking "broad-based" investment exposures, it should not be required to compare itself to a "broad-based" index.

For instance, suppose that a fund investing primarily in technology stocks—which, the proposing release suggests, could not use a technology-focused index as its primary index[52]—outperforms a broad-based index (say, the S&P 500 index) by 10 percentage points over a reporting period. This superficially impressive differential would not indicate how the technology fund performed *as a technology fund*. The fund may have simply benefitted from investing in an outperforming sector, and its performance (compared to a more appropriate technology stock benchmark) may have in fact lagged a more appropriate index. Now, suppose this same technology fund underperforms its required broad-based index by 10 percentage points. Again, it would not be sensible to assume anything from this differential alone. Its performance *as a technology fund*

[50] Holden, Bogdan, and Schrass, "What US Households Consider When They Select Mutual Funds, 2019." *ICI Research Perspective* Vol. 26, No. 2 (April 2020) ("ICI Research Perspective on US Households"), *available at* https://www.ici.org/pdf/per26-02.pdf.

[51] Release at 95.

[52] *See* proposal at 98 ("Some funds, for example, disclose their performance against a benchmark index that may not provide a performance indicator of 'the overall applicable stock or bond markets,' such as an index tied to a particular sector, industry, geographic location, asset class, or strategy (*e.g.*, growth or value indexes)").

may have in fact been strong, when measured against an appropriate index, and it may be performing as intended within an investor's overall portfolio.

A "broad-based" index requirement is not present in other important regulatory contexts. For instance, the Investment Advisers Act provision and related rules that permit funds to pay their advisers performance-based fees require that the calculations be based on "the investment performance of the company or fund…in relation to the investment record of an *appropriate index* of securities prices…."[53] And newly adopted Rule 18f-4 governing funds' use of derivatives includes an appreciably more expansive definition of "designated index" than the definition of "appropriate broad-based securities market index" in Form N-1A.[54] For example, Rule 18f-4 (i) requires that such index "reflect[] the markets or asset classes in which the fund invests," and (ii) permits use of blended indexes, provided that the underlying indexes are not administered by fund affiliates.[55]

The current definition also produces some potentially unwieldy and confusing performance presentations, most notably for multi-asset funds (*e.g.*, balanced funds or funds of funds). Indeed, the difficulty for these funds is that *no* single widely used index may be sufficiently appropriate *or* broad. For instance, it is not uncommon for a target date fund to compare its performance to one or more equity indexes, one or more bond indexes, and finally a "blended" index.[56] A broad-based equity or bond index very well may meet the SEC's definition and yet still provide an inapt comparison for a target date fund due to the greater breadth of the fund's investment exposures. To remedy this, a target date fund may include more indexes in its performance presentations, which may confuse investors. We see no reason why such a fund should not be

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[53] Emphasis added. *See* Section 205(b)(2)(B) of the Investment Advisers Act and Rules 205-1 and -2 thereunder. In related guidance, the SEC has stated that (i) in determining "appropriateness," factors such as the volatility, diversification of holdings, types of securities owned, and investment objectives of the fund should be considered; and (ii) for funds investing exclusively in a particular type of security or industry, either a specialized index adequately representing that type of security or a broad-based index ordinarily would be appropriate. *See Factors to Be Considered in Connection with Investment Company Advisory Contracts Containing Incentive Arrangements*, SEC Release No. IA-315 (Apr. 18, 1972).

[54] Rule 18f-4 under the Investment Company Act defines "designated index" as a type of "designated reference portfolio" that a fund may use to satisfy the relative value-at-risk test.

[55] Like the current definition of "appropriate broad-based securities market index," Rule 18f-4's definition would limit a fund's ability to use affiliated indexes (specifically, a fund may not use an index "administered by an organization that is an affiliated person of the fund, its investment adviser, or principal underwriter, or created at the request of the fund or its investment adviser, unless the index is widely recognized and used."). The derivatives rule, however, also *requires* that an index fund use its tracking index as its designated reference portfolio, notwithstanding the general restrictions on using affiliated indexes. *See Use of Derivatives by Registered Investment Companies and Business Development Companies*, SEC Release No IC-34084 (Nov. 2, 2020) ("Derivatives Rule Release"), *available at* https://www.sec.gov/rules/final/2020/ic-34084.pdf.

[56] A blended index is one that combines the performance of multiple indexes, weighted based on the fund's approximate asset allocation.

permitted to include only an appropriate blended index,[57] provided that it identifies its underlying components and their weights and properly incorporates the returns of those components. We do not object to permitting funds to include multiple indexes (as Form N-1A currently does), but the fund's perceived need to compensate for the shortcomings of its required broad-based index should not drive that choice.

The current definition creates similar challenges for certain alternative strategies funds (*e.g.*, those that seek positive absolute returns, and/or returns with low correlations to those of traditional asset classes). These funds may be designed to have no (or low) correlation to either equity or fixed income markets. As with multi-asset class funds, no broad-based equity or bond index may provide an appropriate point of comparison and could be misleading to investors. But blended indexes also may not work particularly well for alternative strategies funds. For these funds, cash-oriented benchmarks (*e.g.*, an index that measures the performance of US Treasury bills), or even non-securities indexes (*e.g.*, the Consumer Price Index) may provide far more appropriate—and easier to understand—comparative measures in light of such funds' objectives and principal strategies. The returns of alternative strategies funds may correlate much more closely to those of risk-free investments (*e.g.,* cash or US Treasury bills) than to those of equity or fixed income markets, potentially making cash-oriented benchmarks more suitable for performance benchmarking.

We understand the SEC's desire to provide market-wide performance information to investors, for overall context. But in addition to the problems discussed above, including this (usually third-party) information in prospectuses and shareholder reports typically may impose costs on funds, as we discuss below. And yet, performance information for commonly recognized indexes may be free to investors and easily accessible through different widely available channels (*e.g.*, online news or financial websites). In many cases, the requirement to embed index performance information in regulatory documents is duplicative and costly.

Finally, the current definition severely limits the ability of a fund to use an index created and administered by an affiliate (only an affiliated index "widely recognized and used" is eligible as a primary index) and thus creates an unlevel playing field. This is in stark contrast to the approach the SEC took in the ETF rule (Rule 6c-11), where the SEC recognized the place of "self-indexed ETFs" and did not subject them to additional conditions.[58] This limitation also frequently results in inapt performance comparisons, especially for those index funds that track affiliated indexes, while being required to compare their performance to different indexes that they do not seek to track.

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[57] *Cf.* Rule 18f-4(a), *supra*, note 55 and accompanying text.

[58] *See Exchange-Traded Funds*, SEC Release Nos. 33-10695, IC-33646 (Sept. 25, 2019), at 24-25, *available at* www.sec.gov/rules/final/2019/33-10695.pdf. The SEC explained that the ETF rule's portfolio transparency requirements, together with existing federal securities laws, adequately address any special concerns that self-indexed ETFs may present.

We believe that a similarly permissive approach to affiliated indexes here would be appropriate as a matter of policy and help foster competition and lower fund costs. The index market is concentrated, and the top three global players—FTSE Russell, MSCI, and S&P Dow Jones—are estimated to have a 71 percent market share.[59] Moreover, global revenues of the major industry players grew 18.8 percent in 2017 and 13.4 percent in 2018, to $3.5 billion.[60] While it is hard to know what effect SEC regulation has had on the size or development of this growing and concentrated market, regulatory provisions that disfavor new market entrants (such as a definition that strongly favors existing and widely recognized indexes) clearly do not help. The current definition leads to a competitively perverse result where a large index provider could launch new mutual funds and ETFs and include its well-known indexes in the funds' regulatory documents, while a fund complex could not launch new indexes and include them (alone) in the funds' documents. The SEC should avoid creating, or maintaining, regulations that have the unintentional effect of distorting competition.

As noted above, including third-party index performance in regulatory documents may impose costs on funds, and the SEC recognizes this in the proposing release.[61] Fund complexes may enter into licensing agreements with index providers to use their indexes and related information in regulatory documents and elsewhere. The terms of these agreements differ, but they do not necessarily provide funds and advisers with unfettered use of any index that the provider administers. For instance, if a new fund wishes to use as its broad-based index one that is not included in the fund complex's current licensing agreements, the fund typically will incur additional costs to do so. A fund wishing to change indexes (or add "additional indexes") could incur additional costs for these same reasons. Smaller fund complexes with fewer (or more limited) licensing agreements in place may be more likely to incur costs when these events occur. And of course, even if an index is covered under an existing agreement, the agreement's overall cost structure accounts for the right to use index information in regulatory documents, which funds bear.

We believe that broader choice in index selection—including among affiliated indexes, if appropriate—would improve market dynamics. If nothing else, it would provide funds with a measure of control over costs, insofar as funds may be able to select from a wider array of indexes that may not require entering into new or expanded licensing agreements with third

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[59] *Opportunities and Risks in the Financial Index Market*, Autorité Des Marchés Financiers, Laurent Grillet-Aubert (June 2020), at 53, *available at* www.amf-france.org/sites/default/files/2020-06/opportunities-and-risks-in-the-financial-index-markets.pdf.

[60] *Id*.

[61] Release at 95. *See also Statement on Proposal to Improve Information Available to Fund Investors*, SEC Commissioner Elad Roisman (Aug. 5, 2020), *available at* https://www.sec.gov/news/public-statement/roisman-opening-remarks-proposal-improve-investor-information-080520. ("Fund shareholders can pay significant licensing fees for the fund to obtain rights to reference an index in its disclosures.…Second, I worry about entrenching the market power of the major index providers.")

parties. The Commission effectively addressed this concern in the recently adopted derivatives rule, which permits a fund to use its securities portfolio, rather than a designated index, to "avoid the expense associated with blending or licensing an index just for purposes of the final rule's relative VaR test."[62] We recommend that the Commission take a similar approach to the performance reporting requirements.[63]

In light of the foregoing, we recommend that the SEC:

- Require only that a fund compare its performance to an "appropriate" index and define that term (in relevant part) as follows: "An 'appropriate index' is one whose objective (*i.e.*, what it seeks to measure) is reasonably related to the Fund's investment objective and principal investment strategies."[64]
- Provide an alternative to this general requirement, whereby a fund that determines that it does not have an appropriate index (as defined above) could select a cash-oriented benchmark and explain why it is appropriate, given the fund's investment objective and strategies.
- Require that a fund using a blended benchmark (which may serve as an appropriate index) identify its underlying components and their weights.
- Correspondingly amend the definition of "additional indexes" to read: "A Fund may, but is not required, to compare its performance not only to the required appropriate index, but also to other appropriate indexes, so long as the comparison in each case is not misleading."

The recommended changes would eliminate the "broad-based" and "securities market" requirements and the affiliation restriction.

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[62] Derivatives Rule Release at 124.

[63] We recommend that the SEC make the changes outlined in this sub-section of the letter to both Form N-1A for open-end funds and Form N-2 for closed-end funds.

[64] *Cf.* Rule 18f-4(c)(2)(i), *supra*, note 55 ("The fund must comply with the relative VaR test unless the derivatives risk manager reasonably determines that a designated reference portfolio would not provide an appropriate reference portfolio for purposes of the relative VaR test, taking into account the fund's investments, investment objectives, and strategy."). *See also* Global Investment Performance Standards (GIPS®) for Firms 2020, *available at* www.cfainstitute.org/-/media/documents/code/gips/2020-gips-standards-firms.ashx. Under GIPS, firms generally must present benchmark returns in their composite and pooled fund reports, and a benchmark (defined as "a point of reference against which the composite's or pooled fund's returns or risk are compared") used in a GIPS composite or pooled fund report must reflect the investment mandate, objective, or strategy of the composite or pooled fund. Firms also may use custom benchmarks, subject to additional disclosure requirements.

This recommended approach with a renewed focus on "appropriateness," would:

- produce apt and useful performance comparisons for investors;[65]
- permit funds to streamline presentations as they deem appropriate;
- encourage competition in the index market;
- strengthen funds' ability to control related costs for fund shareholders.

<u>Graphical Representation of Holdings</u>

The proposal would retain the existing graphical representation of holdings, which illustrates in a user-friendly format the allocation of the fund's investments across categories (*e.g.*, asset classes, industry sectors, credit ratings, countries, *etc*.).[66] The fund's complete schedule of investments identifying all securities held would be available online and on request. We support the proposed layered approach to disclosure of portfolio holdings and agree it will enable a better summary presentation that investors may review more easily.

The proposal would make one significant change to the currently required graphical representation of holdings. Today, funds can base the presentation on either net assets or total investments. The proposal also would permit presentation based on net exposure or total exposure, to provide a more meaningful presentation for those funds that use derivatives to obtain investment exposure as part of their investment strategy. The proposed change also may benefit long/short funds. Funds that hold both long and short positions may present the long and short positions separately (*i.e.*, total exposure) or show the combined effect of both positions (*i.e.*, net exposure). We support the proposed change and believe that it will enable funds investing in derivatives or employing long/short strategies to provide more informative graphical representations in their shareholder reports.

We recommend that funds be permitted to include a list of top holdings (*e.g.*, top 10 or top 25) as part of the required graphical representation. We believe it is quite common for equity funds to include in their shareholder reports a list of the top holdings along with the percentage of net assets or total investments each holding represents. We believe such lists are informative to shareholders and would not add significantly to the length of the report.

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[65] To the extent that the SEC is concerned that "a fund may choose an index that it is more likely to outperform to make it look like the fund is doing better than the corresponding market" (proposing release at 96), a focus on "appropriateness" (as we recommend that SEC define it) is much more likely to mitigate this concern than the proposed formulation. It is more difficult for a fund, *a priori*, to select an index that it can consistently outperform if both the fund and the index have similar objectives.

[66] Proposed Item 27A(f) of Form N-1A.

Material Fund Changes

The proposal would require a fund to describe briefly in its annual shareholder report any material change with respect to specified items, as well as any other material change that the fund chooses to disclose, that has occurred since the beginning of the reporting period or that the fund plans to make in connection with its annual prospectus update.[67] Disclosure of changes would be accompanied by a prescribed legend.[68] Funds would be required to disclose any changes in the annual shareholder report, even where the shareholder had previously received a prospectus sticker describing the change, making the annual report a complete repository for changes over the period.[69]

The Commission points out that:

> [i]nstead of identifying the types of material changes a fund must disclose and providing flexibility for funds to disclose other material changes, we considered proposing a more principles-based approach. For example, we considered an approach that would direct funds to disclose all material changes, without identifying the categories of material changes they would need to disclose.[70]

We strongly recommend that the Commission *not* identify specific categories of items but instead maintain the existing principles-based approach in any final rule, which would permit each fund to retain discretion to determine the types of changes to disclose. However, we understand that the Commission is concerned that fund complexes have varying practices in this regard and that the Commission desires to set some sort of parameters for the types of changes that need to be "called out" explicitly for investors.

If a "principles-based approach" without identifying specific categories of items is not acceptable to the Commission, then we strongly urge the Commission to, at a minimum, add a baseline for determining the "materiality threshold" with which funds and their counsel already are familiar. The Commission could do so by requiring funds to include any changes for which the fund has

[67] Proposed Item 27A(g) of Form N-1A provides that funds must disclose any material change with respect to: (i) the fund's name, (ii) the fund's investment objectives, (iii) material increases in the fund's ongoing annual fees, transaction fees, or maximum account fee; (iv) the fund's principal investment strategies, (v) principal risks of investing in the fund, (vi) the fund's investment adviser; and (vii) the fund's portfolio manager. The changes would appear in a new section of the annual shareholder report titled "Material Fund Changes."

[68] The legend would indicate, "This is a summary of certain changes [and planned changes] to the fund since [date]. For more complete information, you may review the fund's next prospectus, which we expect to be available by [date] at [website] or upon request at [toll-free telephone number]." Proposed Instruction 2 to Item 27A(g) of Form N-1A.

[69] This would be the case for investors in funds that choose not to rely on Rule 498B.

[70] Release at 136.

filed a Rule 485(a) amendment, which amendment is effective. This would use today's analytical framework with which funds are accustomed. Under the recommended approach, investors still would receive information about changes that have occurred in a designated place with a uniform label, in an already streamlined document. The recommended approach also has the significant benefit of more effectively preserving a fund's judgment as to what matters to disclose.

Materiality is a fluid concept that the courts have interpreted over many years. A particular type of change might reasonably be viewed as material to one fund but not another, given differences in, among other matters, the funds' respective investment objectives, management structure, and risk profile. The fund ultimately bears liability for failing to disclose material changes and therefore has ample incentive to disclose them. Funds also seek to provide shareholders with a readable shareholder report. That objective coupled with the reference to Securities Act Rule 485(a) should protect against funds providing unduly complex and lengthy disclosure and further the Commission's goals of reducing, or eliminating from, shareholder reports information that is less relevant to an investor's decision to remain invested in a fund.

To effectuate the recommended change, the Commission could retitle proposed Item 27A(g) as simply "What Has Changed" and accompany it with an instruction that a fund:

> briefly describe changes that have occurred since the beginning of the reporting period with respect to which the fund has filed an amendment to its registration statement pursuant to Rule 485(a), which amendment is effective. In addition, funds may, but are not required to, describe other changes that have occurred since the beginning of the reporting period.[71]

If the Commission continues to believe, however, that funds should be required to include the proposed enumerated changes in annual shareholder reports, we strongly urge it to make the four recommended changes described below.

First, we recommend that the Commission require a fund to disclose "a change in the fund's principal investment strategies or a change in the principal risks of investing in the fund" only if the fund, in connection with that change, has filed a Rule 485(a) amendment to its registration statement, which amendment is effective. This formulation would permit funds to determine whether to inform shareholders of changes to a fund's investment strategies or principal risks using today's analytical framework for determining whether to file a Rule 485(a) or (b) amendment. The recommended approach would provide funds with much greater certainty around compliance by also requiring that the amendment be effective (thereby reflecting any changes made to the amendment as filed in response to staff review and comment). For example, it would make clear that annual prospectus language updates a fund might make in the normal course to describe its investment strategies or principal risks would not need to be disclosed in

[71] *Cf.* proposed Item 27A(g) of Form N-1A. *See infra*, describing the recommended approach to describing future changes.

the annual shareholder report if the changes would not otherwise warrant filing a Rule 485(a) amendment.[72]

The recommended formulation also is consistent with the Commission's apparent intent to require disclosure of material changes. Yet proposed Item 27A(g) of Form N-1A (and likewise Rule 498B(c)(2)) as drafted could be read to more broadly capture non-material changes and changes that funds make through stickers. Rule 498B(c)(2) references Rule 485 generally (which includes amendments pursuant to Rule 485(b)(1)(v), which include "non-material changes that the registrant deems appropriate."). Rule 498B(c)(2) also references Rule 497, the rule pursuant to which funds may supplement or "sticker" their prospectus or SAI. But currently funds do not mail all prospectus supplements to shareholders. They conduct an analysis and determine whether to file a supplement or also mail the supplement to shareholders. Some funds mail supplements only for material changes while others may choose also to mail supplements for changes that are not material. Given the diversity in practices as to when to sticker and whether to transmit the sticker, we recommend not referring to Rule 497.

Second, we strongly recommend that the Commission eliminate the proposed portfolio manager disclosure from any list of enumerated changes. In most instances, the identity of a portfolio manager's name is of much lesser import than the investment adviser's name (*e.g.,* for index funds) and therefore a portfolio manager change often may not be a material change.[73] Similarly, a portfolio manager change for a manager of manager funds typically is not considered a material change.

Third, we strongly recommend that a fund *not* be required to provide forward-looking information in this section of (or anywhere else in) the annual shareholder report. Our members relayed several issues with the concept of including forward-looking in shareholder reports. Some fund boards must approve any such changes and, until they do, the information is considered to be nonpublic information. Also, any event that has not yet occurred, actually may never occur, or may not occur in the manner first contemplated. For example, a fund could be considering making a change to its investment strategies and ultimately decide against doing so. Making the material fund changes section in the shareholder report backward-looking would

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[72] *See* discussion, *supra*, at 15-18 regarding potential liability concerns in connection with routine prospectus language updates that are not sufficiently material to warrant disclosure in the shareholder report.

[73] Disclosure about sub-advisers would be required, consistent with Item 5(a) of Form N-1A and its instructions. This generally means that (i) a fund would not need to identify a sub-adviser whose sole responsibility for the fund is limited to day-to-day management of the fund's holdings of cash and cash equivalent instruments, and (ii) a fund having three or more sub-advisers, each of which manages a non-significant portion of the fund's portfolio, would not need to identify each such sub-adviser.

We considered recommending that funds be required to disclose portfolio manager changes when that change prompts the fund to file a Rule 485(a) amendment but rejected it because funds generally do not consider portfolio manager changes in isolation to be "material" for purposes of determining whether a post-effective amendment should be filed pursuant to Rule 485(a). We note that if a material change in investment strategy accompanied the portfolio manager change, the fund would file a post-effective amendment under Rule 485(a).

allow existing shareholders to use the reports to monitor their ongoing fund investments efficiently and meaningfully consistent with the inherent general backward-looking nature of shareholder reports. We therefore recommend that the Commission eliminate the proposed language that would direct funds to describe any material change "that the Fund plans to make in connection with updating its prospectus under section 10(a)(3) of the Securities Act for the current fiscal year."

Finally, with respect to the proposed requirement that a fund disclose "with respect to material increases, the fund's ongoing annual fees, transaction fees or maximum account fee" we recommend modifying this to read as "any material increase in contractual fee rates, transaction fees or maximum account fee." The recommended change would make it clear to shareholders that the fund is disclosing an increase in its contractual fee rates (*i.e.,* consisting of a management fee, 12b-1 fee, shareholder servicing fee and custody fee) and that the loss of a breakpoint in the management fee or a change in performance-related expenses (*e.g.*, interest expense, dividend expense on short sales) would not be included for purposes of determining whether there was a material increase in a fund's ongoing annual fees. At a minimum, we recommend that the Commission clarify that a fund need not describe increases that are simply a result of a fund's asset base decreasing.

Statement Regarding Liquidity Risk Management Program

As part of the 2018 liquidity disclosure amendments,[74] open-end funds subject to Rule 22e-4 (the "liquidity rule") must "briefly discuss the operation and effectiveness of the Fund's liquidity risk management program over the past year" in their shareholder reports. The proposed amendments would require these funds to continue including liquidity disclosure in streamlined shareholder reports, subject to modified instructions.[75] Explaining the rationale for these proposed changes, the SEC states that this liquidity disclosure "should be more tailored, concise, and informative to help shareholders better understand how the fund is managing its liquidity risks…."[76]

We continue to support the 2018 liquidity disclosure changes. We also believe, however, that the proposed changes would place undue emphasis on liquidity risk for most funds and likely result in lengthier, less tailored, and less useful liquidity disclosure overall.

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[74] *Investment Company Liquidity Disclosure*, SEC Release No. IC-33142 (June 28, 2018)("Liquidity Disclosure Release"), *available at* www.sec.gov/rules/final/2018/ic-33142.pdf.

[75] Proposed Item 27A(i) of Form N-1A would require funds to "briefly summarize the: (i) key factors or market events that materially affected the fund's liquidity risk during the reporting period; (ii) key features of the Fund's liquidity risk management program; and (iii) effectiveness of the Fund's liquidity risk management program over the past year." Further, proposed Instruction 1 to this Item states, "The disclosure responsive to this item should be tailored to the fund rather than rely on generic, standard disclosures."

[76] Release at 150.

With respect to disclosure placement, we recommend that the SEC:

- require funds to provide this liquidity disclosure in the streamlined shareholder report only if they do *not* (i) meet the definition of "In-Kind ETF" or "primarily highly liquid fund" under the liquidity rule,[77] *or* (ii) consistently hold a majority of their assets in highly liquid investments;[78] and
- permit all other funds to provide their liquidity disclosure on Form N-CSR.

The liquidity rule itself recognizes that In-Kind ETFs and "primarily highly liquid funds" have lower liquidity risk, by exempting them from the Highly Liquid Investment Minimum, or HLIM, requirements.[79] A similar disclosure-related distinction would be consistent with this. We also believe this distinction should be extended to funds that, while not designated as "primarily highly liquid," nevertheless invest a majority of their assets in highly liquid investments. Given the inherent spatial limitations of the streamlined shareholder report, only key items should be included. Generally speaking, we do not believe that liquidity disclosures for these funds will rise to this level of importance.

In some cases, however, these funds could experience elevated liquidity risk and stresses during a period. To account for this possibility, the SEC could reiterate its view that "liquidity events are factors that may materially affect a fund's performance [and] to the extent a liquidity event has such an effect, this event must be discussed in the MDFP."[80] This would ensure that *all* funds would provide relevant liquidity disclosure in these reports, as events and circumstances warrant.

We also recommend changes to the proposed liquidity disclosure instructions. We fully support the SEC's stated goal of making this disclosure "more tailored, concise, and informative." But the proposed changes—which would replace a relatively straightforward requirement with a three-part requirement—would not meet this objective. The second part's programmatic

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[77] *See* Rule 22e-4(a)(9) for the definition of "In-Kind ETF." The rule and its adopting release do not expressly define "primarily highly liquid fund," but the rule exempts such funds (which could include ETFs that do not qualify as "In-Kind ETFs") from the highly liquid investment minimum (HLIM) requirements. *See Investment Company Liquidity Risk Management Programs*, SEC Release Nos. 33- 10233; IC–32315 (Oct. 13, 2016), at n.726, *available at* www.sec.gov/rules/final/2016/33-10233.pdf. ("In our view, if a fund held less than 50 percent of its assets in highly liquid investments it would be unlikely to qualify as 'primarily' holding assets that are highly liquid investments.")

[78] This second category would include funds that may in fact qualify as "primarily highly liquid funds" but may not designate themselves as such and may still choose to set and operate under an HLIM. In other words, this test would relate to portfolio liquidity, rather than formal designation as a "primarily highly liquid fund" or the presence of an HLIM.

[79] In-Kind ETFs also are exempt from the rule's bucketing requirements.

[80] Liquidity Disclosure Release at 15. It continues, "This discussion of liquidity events in the MDFP should include sufficient specificity that investors can understand the liquidity event, how it affected performance, and any other relevant market conditions."

emphasis (summarizing "key features of the Fund's liquidity risk management program") is likely to produce the type of lengthy and boilerplate disclosure (*e.g.,* recitations of liquidity rule requirements or standard program features) that the SEC seeks to avoid. Further, we believe that most funds would not have anything meaningful to disclose for most periods in response to the first part of the instruction (summarizing "key factors or market events that materially affected the fund's liquidity risk during the reporting period"). Funds with low liquidity risk will be hard-pressed to identify factors or market events *materially affecting* this low-level risk.

In light of the SEC staff's assessment of disclosures submitted to date and our comments above, we recommend modifying the current requirement to require a fund to "briefly discuss the fund's liquidity risk, and how that risk was managed, during the period." For funds with low and well-managed liquidity risk during a period, a concise statement should suffice, along with a brief explanation as to *why* the risk was low and well-managed.[81] In this regard, we also note that funds with similarly low-risk liquidity profiles during a period are unlikely to have meaningfully divergent disclosures—in these cases brief disclosures therefore should meet the Commission's policy objectives.[82] Our recommended modifications would allow funds to appropriately contextualize their liquidity risk thereby producing useful liquidity disclosure for investors.

Exempt Funds Offered Exclusively to Other Funds from the Obligation to Prepare Shareholder Reports

The Commission indicates that the proposed streamlined shareholder report is intended to "highlight information that we believe is particularly important for retail shareholders to assess and monitor their ongoing fund investments."[83] While we strongly support the proposed streamlined shareholder report and firmly believe that it will enhance shareholders' ability to monitor the performance of their fund investments, we see little benefit in requiring funds offered exclusively to other funds (i.e., serving only as acquired funds) to prepare, transmit and file the retail-oriented report.

Funds investing in other funds could instead rely on the financial statements and other Form N-CSR information, which the acquired fund prepares and files. Those financial statements contain

[81] Of course, a fund's liquidity risk during a period could be elevated due to external factors and have nothing to do with the quality of the fund's liquidity risk management program.

[82] Accordingly, we also recommend either deleting proposed Instruction 1, which would require tailored disclosure, or amending it to state: "The disclosure responsive to this item should be tailored to the extent practicable, commensurate with the magnitude of the fund's liquidity risk experienced during the period." This revised instruction would help give effect to the guidance in footnote 305 of the release ("[W]e generally believe it would be appropriate for funds in a fund group with similar investments, and that are subject to the same liquidity risks, to use the same disclosure.").

[83] Release at 10.

more detailed information on the acquired fund's performance, expenses, and portfolio holdings than the retail-oriented shareholder report, clearly obviating the need to prepare, file and transmit the report.

Bundling of Certain Shareholder Reports

The Commission would specify the design and content of funds' annual and semiannual shareholder reports.[84] The proposal would require each portfolio or series in a multi-series trust to prepare a separate shareholder report to limit the overall length and complexity of shareholder reports. Currently, registrants may prepare a single shareholder report that covers multiple series.

We recommend that the Commission allow underlying funds of variable insurance products, target date funds, target risk funds, money market funds, and state tax-exempt funds to be bundled in a single shareholder report. Target date funds and target risk funds in a fund complex may follow a similar underlying investment philosophy (*e.g.*, target date funds may have a similar underlying glide path). Therefore, requiring each fund to be in a separate report will impose costs without any discernable benefit. Money market funds pursue similar investment objectives through differing investment strategies (*e.g.*, Treasury, Federal, prime, *etc.*). For state-specific funds, investors would be able to easily choose among the options if they are looking to invest in their resident state (*e.g.,* to reduce state tax obligation). This flexibility would allow funds to efficiently organize all of their state-specific options in one report.

In response to the Commission's request for comment on whether certain types of funds should be excluded from this requirement, we believe that the proposal should be revised to make clear that insurance companies providing fund shareholder reports to contract holders may provide combined reports for funds available under a particular product, as is permitted by Rule 498 and Rule 30e-3. Such a combined presentation will be consistent with the manner in which contract holders are used to seeing fund information. Contrary to the Commission's concerns, permitting insurance companies to combine underlying fund reports for delivery to contract holders will promote user-friendliness of these reports for contract holders and reduce confusion. Prohibiting insurance companies from combining fund reports, which would be a departure from their current practices, would also increase costs and burdens, which may be passed on to underlying funds in fund participation agreements.

The Commission has consistently recognized the benefits of permitting the combination of underlying fund materials for contract holders, even where such combination is not permitted for funds sold directly to investors. For example, Rule 498 provides an exception to the binding prohibition for underlying fund summary prospectuses, as does Rule 30e-3. The Commission should provide the same flexibility for combining underlying fund shareholder reports in proposed Instruction 4.

[84] Proposed Item 27A of Form N-1A.

Selected Comments on Form N-CSR and Website Availability Requirements

Generally, information currently included in shareholder reports that would be omitted from the proposed streamlined shareholder report would be filed on Form N-CSR and posted to the fund's website. The proposed Form N-CSR filing and website posting requirements would layer disclosure by making the information omitted from shareholder reports available to those investors who seek more in-depth information.[85] As with our comments on the streamlined shareholder report, we support much of what the Commission has proposed with respect to Form N-CSR. We therefore express our support for, or recommend minor modifications to, several provisions on an item-by-item basis in Appendix B. We provide our more significant comments on Proposed Form N-CSR immediately below.

Potential Liability Considerations

Under the proposed amendments to Form N-1A, streamlined annual and semiannual shareholder reports would be the primary source of fund disclosure for existing shareholders. Certain information now required in shareholder reports, such as the fund's financial statements, would no longer appear in these reports. Instead, this information would be made available online and delivered free of charge upon request and filed with the SEC on a semiannual basis on Form N-CSR. The proposed amendments to Form N-1A would not permit a fund to incorporate by reference into its shareholder reports any information located in other disclosure documents.

In the event these proposed amendments to Form N-1A are adopted, there will be potential scenarios where information contained in Form N-CSR—but not in the streamlined shareholder report—could be relevant to the defense of a shareholder litigation. For example, complete portfolio holdings information can be important in shareholder litigation defense, when plaintiffs claim to have been misled by a fund's disclosures about the types of securities the fund would hold. Under the proposed revised structure, plaintiffs can be expected to allege that such holdings information was "minimized" or "buried" because it was included only in the online Form N-CSR, and merely summarized in the shareholder report sent to investors. Plaintiffs might attempt to support such an argument by pointing out that detailed information in a fund's SAI may be incorporated by reference into its statutory prospectus, but the same is not true for information omitted from the shareholder report.

Here again, the Commission's goal of streamlining and layering the information that is provided to shareholders should not come at the expense of funds and others facing such meritless arguments in shareholder litigation. We therefore recommend that proposed amendments to Form N-1A, if adopted, be accompanied by Commission guidance clarifying that the

[85] Information omitted from shareholder reports and filed on Form N-CSR and posted to fund websites would include: (i) financial statements; (ii) financial highlights; (iii) compensation paid to directors and officers; (iv) changes in and disagreements with accountants; (v) matters submitted to fund shareholders for a vote; and (vi) the statement regarding the basis for the board's approval of investment advisory contract. In addition, the proposal would require the fund to post on its website complete portfolio holdings as of the fund's first and third fiscal quarter end in Regulation S-X format.

amendments are not intended to alter the total mix of information available to shareholders or otherwise affect how courts should assess fund disclosures for purposes of shareholder litigation. In particular, all information set forth in a fund's Form N-CSR should be considered part of the total mix of information available to investors, even though such information cannot be included or incorporated by reference into the streamlined annual or semiannual reports.

Combined Financial Statements in Form N-CSR

The proposal would require each series or portfolio in a trust to prepare a separate shareholder report, and shareholder reports could not be combined into one document.[86] We seek confirmation that separate series or portfolios may prepare and file combined financial statements to satisfy Item 7 of Form N-CSR and that those combined financial statements could satisfy the shareholder report linking requirements in Item 27A[87] and website posting requirements in Rule 30e-1.[88] Requiring funds that currently prepare combined financial statements to prepare separate financial statements would entail significant cost with little or no benefit to investors.

Funds with the same fiscal year end may prepare combined financial statements. In combined financial statements each row on the page represents the amount relating to a required financial statement caption (*e.g.*, interest income, management fees, realized gains, *etc.*) and each column corresponds to one of several funds in the combined financial statements. Such combined financial statements also present the notes to the financial statements in a combined fashion. For example, the management fees note would provide the management fee rates and fees paid over the reporting period for each of the several funds. Combined financial statements typically have one auditor's report covering all the funds in the combined financial statements. We believe it is common for funds today to prepare and file shareholder reports that cover several different funds (*e.g.*, a suite of state tax-exempt funds, money market funds, target risk funds, or target date retirement funds) and that those shareholder reports present the funds' financial statements on a combined basis.

[86] Proposed Instruction 4 to Item 27A(a) of Form N-1A.

[87] Proposed Item 27A(a), Instruction 9 requires the fund in an electronic shareholder report to link to the fund's financial statements and indicates that the link must be specific enough to lead investors directly to the particular information.

[88] Proposed Rule 30e-1(b)(2)((vii) would require the financial statements and other information to be separately available for each series of a fund or grouped by the types of materials and/or by series, so long as the information…provides a means of easily locating the relevant information (including, for example, a table of contents that includes hyperlinks to the specific materials and series).

Proposed Form N-CSR Filing Requirements

We strongly recommend that the Commission confirm that a trust may prepare and file a combined Form N-CSR that covers multiple series or portfolios, notwithstanding the proscription on combined shareholder reports. If the Commission requires each series or portfolio to prepare a separate shareholder report as proposed, we envision the separate shareholder reports by series or portfolio would appear sequentially at Item 1 of the combined Form N-CSR. The recommended approach, preparing separate shareholder reports by series and a combined Form N-CSR covering all series in the trust, is consistent with the Commission's requirements for preparing the summary prospectus (requiring a separate summary for each series) and the statutory prospectus (covering all series in the trust). Requiring separate N-CSR filings for each series or portfolio in a trust would serve no useful purpose and yet would increase dramatically filing burdens and costs.[89]

Proposed Website Content Requirements

All the information that the proposal would move to Form N-CSR would be required to be available on the fund's website not more than 70 days after the end of the fiscal half-year or fiscal year.[90] That information would remain on the fund's website until 70 days after the next respective period end.

The proposing release requests comment on moving the first and third fiscal quarter portfolio holdings filing requirement from Form N-PORT (*i.e.*, Part F of the N-PORT relating to the third and ninth fiscal month) to Form N-CSR. We recommend against such change, as it would require funds to make two additional N-CSR filings per year, and favor retaining the existing Form N-PORT reporting requirements.

As with our comments on the streamlined shareholder report and Form N-CSR, we support much of what the Commission has proposed with respect to the prospectus. We therefore express our support for, or recommend minor modifications to, several provisions on an item-by-item basis in Appendix B. We provide additional comments on the prospectus immediately below.

[89] For example, a combined Form N-CSR filing that today covers ten separate series would instead become ten separate Form N-CSR filings if the Commission were to require separate filings by series. The principal executive and principal financial officer would have to prepare ten separate Sarbanes-Oxley certifications, rather than one certification covering all the series.

[90] Proposed Rule 30e-1(b)(2)(i).

Improved Prospectus Fee Disclosures

The proposal would replace the existing fee table in the summary section of the prospectus with a simplified "fee summary" intended to improve investor comprehension.[91] The existing fee table would be moved further back in the statutory prospectus[92] where shareholders seeking more detail could access it. The information in the fee summary would amount to a subset of the information in the more detailed fee table, although the fee amounts appearing in each would be same.[93]

While the fee amounts included in each fee presentation would be the same, the fee summary would provide less detail. Specifically, annual fund operating expenses would be presented as one line item in the fee summary[94] versus up to seven line items in the fee table.[95] Also, the proposed example illustrating the dollar amount of costs incurred on a $10,000 investment over specified time periods assuming a 5 percent annual return would be shortened from four time periods (*i.e.*, 1, 3, 5, and 10 years) to two time periods (*i.e.*, 1 and 10 years).

At the same time, the proposal would add information into the proposed fee summary not included in the current and proposed fee tables. Specifically, the proposal would require each line item in the fee summary to show the cost investors would pay in dollars assuming a $10,000 investment.[96] The proposal notes as justification that investors may better appreciate the impact of costs when expressed as a dollar amount rather than a percentage of assets. The proposal acknowledges that this proposed addition would add some marginal length to the fee summary but suggests it is appropriate when balanced against the need to effectively communicate the impact of fund costs.[97]

We strongly oppose the proposed fee summary and recommend that the SEC instead retain the existing fee table as Item 3 of Form N-1A. We view the proposed fee summary as providing

[91] Proposed Item 3 of Form N-1A.

[92] Proposed Item 8A of Form N-1A.

[93] Like the existing fee table, the fee summary would provide information on transaction fees (*e.g.,* sales charges), annual fund operating expenses, and an example illustrating the dollar amount of costs incurred on a $10,000 investment over specified time periods assuming a 5 percent return.

[94] Proposed Item 3 would permit one caption: ongoing annual fees.

[95] Proposed Item 8A would permit separate captions for management fees, selling fees, total other expenses, up to three sub-captions for other expenses, and total ongoing annual fees.

[96] Proposed Instructions 2, 3 and 4(c) to Item 3 of N-1A. The proposed dollar cost would be in addition to the currently required percentage cost.

[97] Release at 274.

substantively the same information as the existing fee table and see no benefit to presenting the same information twice. Indeed, doing so adds unnecessary length and complexity to the prospectus and having two separate presentations of the same information likely will confuse shareholders. Also, requiring funds to present the same information twice is at odds with the "layered" approach taken with the proposed shareholder report (where information deemed of lesser importance or lesser interest would be moved to Form N-CSR and made available upon request). Finally, we believe the current fee table provides a comprehensive, yet concise, presentation of the fund's fees and expenses and see no need to simplify it.

We also question the benefit associated with requiring each line item in the fee summary to show the cost investors would pay in dollars assuming a $10,000 investment. We are concerned that this requirement would add considerable length and complexity to the proposed fee summary, particularly in the case of a multiclass fund where transaction charges and ongoing expenses vary by class. We believe this element of the proposal is counterproductive to the stated goal of shortening and simplifying the fee presentation. Furthermore, the proposed requirement seems in part redundant of the expense example showing the amount of costs incurred on a $10,000 investment over varying time periods. For all these reasons, we oppose the proposed requirement to show the amount in dollars an investor would pay on a $10,000 investment.

New, Simplified Fee Terminology

The proposal would change the terminology that funds use to describe fees in the prospectus. These changes are intended to enhance shareholder understanding by using everyday language and more effectively communicating the nature of the fees and charges. For example, "maximum sales charge (load) imposed on purchases" would be replaced by "purchase charge."[98] These proposed terminology changes would apply to both the fee summary and the fee table.

We recommend that the Commission perform investor testing of the proposed terminology changes to ensure that they do in fact improve understanding before proceeding. While certain of the terms may enhance comprehension, we believe others have the potential to cause confusion

[98] Additional proposed terminology changes are described in the table below.

Current Caption	Proposed Caption
Shareholder Fees	Transaction Fees
Annual Fund Operating Expenses	Ongoing Annual Fees
Maximum Deferred Sales Charge (Load)	Exit Charge
Redemption Fee	Early Exit Fee
Total Annual Fund Operating Expenses	Ongoing Annual Fees
Distribution [and/or Service] (12b-1) Fees	Selling Fees
Fee Waiver [and/or Expense Reimbursement]	Temporary Discount
Total Annual Fund Operating Expenses After Fee Waiver [and/or Expense Reimbursement]	[Total] Ongoing Annual Fees with Temporary Discount

or may be misleading. We have specific concerns with “exit charge,” “early exit fee,” “selling fees,” and “temporary discount.”

First, “early exit charge” and “exit fee” are substantially similar and we are unsure that shareholders will appreciate the distinction between these two terms. We therefore recommend that the Commission discard “early exit fee” and retain “redemption fee.” Second, we are concerned that “selling fees” may be misinterpreted to mean a fee for selling or redeeming fund shares. And that “distribution and service fees” better describes amounts paid to the selling broker for ongoing servicing of the shareholder account. We therefore recommend that the SEC omit “selling fees” in favor of the currently required “distribution and/or service fees.” Finally, as explained immediately below, we believe “temporary discount” falsely implies that the termination of the waiver or reimbursement is imminent.

Presently if there are expense reimbursement or fee waiver arrangements that will reduce any fund operating expenses for no less than one year from the effective date of the prospectus, a fund may add two captions to the fee table: one caption showing the amount of the fee waiver and a second caption showing the fund’s net expenses after the fee waiver or reimbursement.[99] The proposal would permit one additional line in the fee summary: “ongoing annual fees with temporary discount” (displaying the amount of ongoing annual fees after waiver or reimbursement).[100] The proposal would permit two additional lines in the fee table: “temporary discount” (showing the amount of the waiver or reimbursement); and “total ongoing annual fees with temporary discount” (displaying the ongoing annual fees after waiver or reimbursement).[101]

We believe use of the term “temporary” to describe the fee waiver or reimbursement suggests that termination of the waiver is imminent and conflicts with the requirement that the waiver be in place for no less than one year from the effective date of the prospectus. Furthermore, advisers may waive their fees for several consecutive years for funds, even though the adviser commits to waive only for the current year, so as to be able to disclose the waiver in the prospectus fee table. Where the adviser has no present intention of discontinuing such an arrangement that may in fact remain in place for years, characterization of that waiver as “temporary” could be considered

[99] Instruction 3(e) to Item 3 of Form N-1A. If the fund provides these captions it must also state the period for which the expense waiver or reimbursement is expected to continue, including the termination date, and briefly describe who can terminate the arrangement and under what circumstances.

[100] Proposed Instruction 4(b) to Item 3 of Form N-1A. The fund would be required to provide a footnote stating the expected termination date of the temporary discount.

[101] Proposed Instruction 4(e) to Item 8A of Form N-1A. The fund would be required to provide a footnote disclosing the period for which the discount is expected to continue, including the expected termination date and who can terminate the arrangement and under what circumstances.

misleading. We therefore recommend that the Commission retain the existing terminology to describe fee waivers and reimbursements and avoid their characterization as temporary.

Acquired Fund Fees and Expenses

The proposal would permit funds that invest 10 percent or less of their total assets in acquired funds to omit the AFFE line item from the fee table and exclude AFFE from the fee table expense ratio, and instead disclose the amount of the fund's AFFE in a footnote to the fee table.[102] Funds investing 10 percent or less of their total assets in acquired funds similarly would exclude AFFE from the ongoing annual fees amount in the fee summary and disclose the amount of the fund's AFFE in a footnote.[103]

AFFE disclosure is designed to provide investors with a better understanding of the costs of investing in a fund that invests in other funds and the resulting layering of costs. AFFE are not expenses under generally accepted accounting principles and thus are not reflected in the expense ratio in the fund's financial statements and shareholder report.[104]

The Commission amended Form N-1A to require disclosure of AFFE as part of the fund of funds rules adopted in 2006,[105] and funds have disclosed AFFE in the prospectus fee table since that time. The Institute and others have recommended that investments in BDCs[106] be excluded from "acquired funds" for purposes of calculating AFFE.[107]

We support the proposed 10 percent of assets threshold that would permit a fund to exclude AFFE from the fee summary and fee table expense ratio and require disclosure of the AFFE

[102] Proposed Instruction 4(f) to Item 8A of Form N-1A. Funds that invest more than 10 percent of their total assets in acquired funds would continue to present AFFE as a line item in the fee table and include it in the bottom-line expense ratio.

[103] Proposed Instruction 4(d) to Item 3 of Form N-1A.

[104] Instruction 4(b) to Item 13(a) and Instruction 1(c) to Item 27(d)(1) of Form N-1A.

[105] *Fund of Funds Investments*, SEC Release Nos. 33-8713; IC-27399 (June 20, 2006), *available at* https://www.sec.gov/rules/final/2006/33-8713.pdf.

[106] A BDC is a type of closed-end investment company created by Congress for the purpose of making capital more readily available to certain types of companies. A BDC must invest at least 70 percent of its assets in "eligible portfolio company," and certain other securities. BDCs compete with various lenders to provide financing to certain companies.

[107] That recommendation was based on the notion that an investment in a BDC is more like an investment in an operating company than an investment company. Also, because BDCs typically are financed with debt and incur significant interest expense, AFFE relating to an investment in a BDC can be significant and may inappropriately discourage fund investment in BDCs. *See* ICI Retail Investor Experience Letter at 36-37.

amount in a footnote. We believe the proposed 10 percent threshold will appropriately focus investors on those funds where investments in other investment companies is a significant part of the fund's overall investment strategy.[108] The proposed footnote requirement will, at the same time, ensure investors' continued access to AFFE information for funds investing only a small portion of their assets in other investment companies. We also support the exclusion of money market funds from acquired funds and agree those investments do not raise the concerns AFFE disclosure is intended to address.

The proposal also includes an instruction for measuring the 10 percent threshold.[109] That instruction requires the fund to calculate its investment in acquired funds based on the average of month-end holdings over the preceding fiscal year in connection with its annual prospectus update. The proposal would not require a fund to assess whether it may disclose AFFE in a footnote on a monthly basis going forward or to update its prospectus fee table based solely on such monthly assessments. We support the proposed methodology and instruction for measuring the 10 percent threshold and agree that they should deter any gaming behavior associated with a single point in time measurement. We also support the proposed instruction enabling a fund to explain why the total ongoing annual fees in the fee table do not correlate to the expense presentation in fund's shareholder report.[110]

We continue to believe that BDCs should be excluded from "acquired funds" for purposes of calculating AFFE. Because of the nature of their business, BDCs typically have high expense ratios relative to traditional open-end and closed-end funds. For example, BDCs typically finance a substantial portion of their investment portfolio through borrowing and the interest paid is included in the expense ratio. In addition, the expense ratio is based on net assets (*i.e.,* the borrowed funds are a liability and are excluded from the asset base on which the expense ratio is calculated). For these reasons, BDC's expenses are more like an operating company's expenses. Therefore, we recommend that the Commission permit funds to exclude BDCs from "acquired fund" for purposes of the required fee table presentation.

<u>Performance Expenses</u>

Under the proposal the "ongoing annual fee" amount in the fee summary and fee table generally would be the same figure that funds currently report as "total annual fund operating expenses"

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[108] Where a fund invests 10 percent or less of its assets in acquired funds, the proposal generally would result in the fee table expense ratio aligning with the expense ratio disclosed in the fund's shareholder report and reduce shareholder confusion.

[109] Proposed Instruction 4(f)(ii) to Item 8A of Form N-1A.

[110] Proposed Instruction 4(f)(viii) to Item 8A of Form N-1A.

(*i.e.*, the expense ratio).[111] The proposal requests comment on whether the expense ratio should include currently excluded performance-related expenses—such as securities lending costs or fund transaction costs. Alternatively, it asks whether performance-related expenses that are included in the expense ratio, such as interest expense on borrowings or dividends paid on short sales, should be excluded from the expense ratio.

Significantly, where performance-related costs are excluded from the fund's expense ratio they are, nevertheless, deducted from fund assets and diminish the fund's total return. For example, brokerage commissions paid on portfolio transactions are included in the cost basis of securities purchased and deducted from proceeds on sale and thus reduce reported gains (or increase reported losses). Securities lending fees paid are typically offset against income earned from securities lending and the net amount is reported as securities lending income in the fund's statement of operations (*i.e.*, the fees paid reduce the reported amount of income). Furthermore, these costs are fully disclosed in the SAI under existing N-1A disclosure requirements,[112] and the fee table discloses the fund's portfolio turnover rate and includes a related statement about transaction costs.[113]

We recommend that the Commission exclude performance-related expenses from the fund's prospectus fee table expense ratio. Our recommendation would focus the fee table expense ratio on the fund's recurring operating expenses (*i.e.*, management fees, 12b-1 fees, shareholder servicing fees, custody fees, audit fees, registration fees, trustee fees, *etc.*) and enhance investors' ability to compare operating expenses across funds. Specifically, by excluding performance-related expenses from the fee table expense presentation, investors would be able to compare recurring operating expenses on an "apples to apples" basis.

Under our recommendation, interest expense paid on borrowings and dividends paid on short sales would be excluded from the fee table expense ratio. We believe these costs are best viewed as investing strategy-related expenses. Mixing these strategy-related expenses into the fee table presentation causes funds employing them to appear more expensive than funds that do not.[114] Furthermore, funds engage in these strategies where they believe there is opportunity to increase the fund's return on a net basis (*i.e.*, the incremental return earned on the strategy exceeds the

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[111] As described above if a fund invests 10 percent or less of its assets in acquired funds the proposal would permit it to exclude AFFE from the ongoing annual fee amount and include AFFE in a footnote.

[112] Funds must disclose the aggregate brokerage commissions paid for each of the last three fiscal years. *See* Item 21(a) of Form N-1A. Funds also must disclose all fees paid in connection with securities lending, including any revenue split and fees paid for cash collateral management services. *See* Item 19(i) of Form N-1A.

[113] Item 3 of Form N-1A.

[114] The manner in which a fund pursues a given strategy may also affect the expense ratio. For example, a fund that pursues short exposure through a derivatives contract versus a fund that sells short equity securities and incurs dividends paid expense.

related cost). Requiring the fee table presentation to include these costs without any context or mention of the potential for increased net returns discourages funds from employing them, even where they may be beneficial to shareholders.

Excluding these expenses from the fee table expense presentation also would provide investors with a more stable measure of recurring operating expenses, because interest and dividend expenses can vary significantly over time, depending on market conditions.

Under our recommendation, interest expense and dividends paid on short sales would continue to be disclosed in the fund's statement of operations and reflected as expenses in the expense ratio included in the fund's financial statements and shareholder report. If the Commission adopts our recommendation, it could consider adding a qualitative statement to the fee table—like that currently required for portfolio turnover and related transaction costs—addressing securities lending fees paid, interest expense, and dividends paid on short sales, if incurred and material, explaining that they are excluded from the fee table expense presentation and referencing the fund's SAI and financial statements.

Personalized Disclosures on Fees and Expenses

The SEC's 2018 retail investor experience release also asked about the adequacy of fund expense information and whether customized (*i.e.*, investor-specific) expense calculations from a fund would be preferable.[115] The proposal would encourage funds to include in "an annual or semi-annual shareholder report that appears on a website or is otherwise provided electronically" "to use online tools (for example, tools that populate discrete sets of information based on investor selections…)…."[116] The proposal also would permit funds to use expense calculators in these electronic reports.

We support the proposed approach, which builds on existing disclosure requirements and encourages voluntary practices. We believe that the continued evolution and adoption of these current tools and practices usefully complement required uniform expense disclosures in prospectuses and shareholder reports, in a pragmatic and cost-effective way.

The proposal also asks questions about the feasibility of personalized expense information (*e.g.*, in quarterly account statements or through other mechanisms).[117] Consistent with views we expressed in 2018, we strongly oppose mandatory customized expense information of this

[115] *Request for Comment on Fund Retail Investor Experience and Disclosure*, SEC Release Nos. 33-10503; 34-83376; IC-33113 (June 5, 2018) ("Retail Investor Experience Release"), *available at* www.sec.gov/rules/other/2018/33-10503.pdf.

[116] Proposed Instruction 8 to Item 27A(a) of Form N-1A.

[117] Release at 85.

kind.[118] Along with the fee and expense table in the prospectus, fund expense examples appear in the prospectus and annual and semiannual shareholder reports. A requirement for individualized expense information would have exceptionally high costs, logistical and legal complexity (*e.g.*, often it is intermediaries—not funds—that hold shareholder-specific information, and the SEC does not have authority to regulate all fund intermediaries), and is unnecessary because of calculators and other resources already available for investors.

Current investor behavior and trends in fund expenses each suggest that existing expense disclosure requirements and voluntary practices are sufficiently educating investors about the fees they pay. Recent ICI investor research demonstrates that fund fees and expenses were a very important consideration in fund selection. In 2019, about nine in 10 mutual fund–owning households indicated they reviewed the fund's fees and expenses, with more than 40 percent indicating the fund's fees and expenses were very important when making their purchase decision.[119]

Moreover, mutual fund investors tend to concentrate their assets in lower-cost funds. On an asset-weighted basis, average expense ratios incurred by mutual fund investors have fallen substantially:

- in 2000, equity mutual fund investors incurred expense ratios of 0.99 percent; by 2019, that average had fallen to 0.52 percent, a 47 percent decline;
- the average hybrid mutual fund expense ratio fell from 0.89 percent in 2000 to 0.62 percent in 2019, a reduction of 30 percent; and
- the average bond mutual fund expense ratio fell from 0.76 percent in 2000 to 0.48 percent in 2019, a decline of 37 percent.[120]

In short, there is no market failure in this area requiring a costly and legally and operationally impracticable overhaul of existing requirements, systems, and practices. The proposal appears to recognize this (at least implicitly) and wisely focuses on potential incremental improvements.

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[118] ICI Retail Investor Experience Letter at 4, 30-34.

[119] ICI Research Perspective on US Households, *supra*, note 50. Households that place less emphasis on fees and expenses may be choosing among a set of funds already prescreened for them by financial advisers or defined contribution retirement plan sponsors, which considered fees and expenses when building the fund lineup.

[120] *See* 2020 Investment Company Fact Book, at 118, *available at* www.ici.org/pdf/2020_factbook.pdf.

ICI Opposes the Proposed Prospectus Risk Disclosure

The Commission proposed revising how a fund must disclose in its prospectus the principal risks of investing in the fund.[121] The proposal specifically would amend several aspects of the current risk disclosure requirements by:

- requiring funds, in determining whether a risk is a principal risk, to consider both whether the risk would place more than 10 percent of the fund's assets at risk ("10 percent standard") and whether it is reasonably likely that a risk will meet this 10 percent standard in the future;
- prohibiting funds from disclosing non-principal risks;
- requiring funds to briefly disclose principal risks in order of importance, with the most significant risks appearing first;
- prohibiting funds from describing principal risks in alphabetical order; and
- requiring funds to tailor risk disclosures to how the fund operates, rather than rely on generic, standard risk disclosures.

The Commission explains that it proposed the 10 percent standard and the ordering requirement because funds use varying standards to determine whether a risk is a principal risk, which makes it difficult for an investor to compare risks among funds.

We recommend several modifications to the proposed approach to sufficiently inform investors of risk while continuing to allow funds to appropriately design their risk disclosure. When the Commission adopted Investment Company Act Rule 498, the summary prospectus rule, it instructed funds to:

> summarize the principal risks of investing in the Fund including the risks to which the Fund's portfolio as a whole is subject and the circumstances reasonably likely to affect adversely the Fund's net asset value, yield, and total return.[122]

One fund reasonably may view a risk as principal, but another may not, given differences in, among other matters, the funds' respective investment objectives, holdings, strategies, and risk profile.

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[121] The Commission states that Items 4 and 9 of Form N-1A explain how a fund should disclose the principal risks of investing in the fund. Item 4 requires that the fund summarize the principal risks in the summary section of the statutory prospectus (which also is included in the summary prospectus, for those funds relying on Rule 498). The Commission further explains that the information that a fund currently provides in response to Item 4 must be based on the information that the fund provides in response to Item 9(c) of Form N-1A, which requires that the registrant disclose only the principal risks of the fund.

[122] Form N-1A, Item 4(b)(1) Risk Return Summary: Investment Risks, Principal Investment Strategies, Related Risks, and Disclosure of Portfolio Holdings, Instruction 2.

A fund's prospectus is an important document for liability purposes, and we are concerned that requiring funds to prospectively determine the degree of each risk is likely to be second guessed with 20/20 hindsight even though it is not always possible to anticipate market dislocations or other developments that affect the fund's risk profile.[123]

Statutory Prospectus Disclosure: 10 Percent Standard and Non-Principal Risks

As referenced above, the Commission proposes requiring funds, in determining whether a risk is a principal risk, to consider both whether the risk would place more than 10 percent of the fund's assets at risk and whether it is "reasonably likely" that a risk will meet this 10 percent standard in the future. We strongly urge the Commission to eliminate the proposed requirement.

The proposed 10 percent standards require more precision than is possible.[124] In addition, funds may use different methods to meet the 10 percent standards, which will make it difficult for investors to compare funds. For example, a fund might measure it by assessing the fund's exposure to an industry (*e.g.,* financial services), or by a segment of an industry (*e.g.,* regional banking), or by geographical area. Implementing this arbitrary threshold may increase the volume of disclosure, an outcome which is at odds with the Commission's policy objectives.

Further, we are concerned that funds trying to monitor or manage to a 10 percent standard may result in diverting advisory personnel's time from managing the fund to continuously assessing and quantifying material risks for disclosure purposes. Shareholders would be better served if advisory personnel instead focused on risk for portfolio and risk management purposes.[125]

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[123] For example, it was not possible for funds to predict the risks presented by COVID-19.

[124] The Release explains that the "reasonably likely" language is designed to reflect that a risk may not be a principal risk when first disclosed but may become a principal risk over time, due to changing conditions or the fund changing its strategies. For example, interest rate risk for a fixed-income fund could increase depending on government action that affects interest rates. As another example, a fund investing in US equities may change its strategy to include foreign investments and thus may introduce foreign investment risk. Therefore, if the fund considers it reasonably likely that a risk will become a principal risk in the future, it should consider whether to include it in the prospectus to help ensure that when it becomes a principal risk, investors will be informed. The Commission further states that "[o]n the other hand, the proposed 'reasonably likely' language reflects our view that risks that are not likely to become principal risks should be excluded from a fund's principal risk disclosure, consistent with the purpose of streamlining the prospectus." Release at 314-315.

[125] If the Commission retains this requirement, then it should state in any adopting release that it does not consider a new risk exceeding the 10 percent standard (or reordering of risks) to necessarily be a change that would require a fund to promptly amend its prospectus and correspondingly inform shareholders, or to subsequently amend its registration statement pursuant to a Rule 485(a) filing. Rather, the fund has the responsibility for determining the necessary actions (if any) using a facts and circumstances-based approach. We further recommend that if the Commission determines to maintain the 10 percent standard, it should, at a minimum, not require a fund to amend its disclosure between annual updates if the percentage of assets at risk changes because fund assets increase or decrease.

Regardless of how the Commission ultimately articulates the standard for determining principal risks in the amended rules, the fact remains that non-principal risks could come to fruition (singly or in combination) and negatively affect a fund's performance. In that circumstance, shareholder litigation might result, and plaintiffs could be expected to allege that the fund's disclosures were misleading because the risks that caused shareholder losses were "minimized" or "de-emphasized" by being disclosed only as non-principal risks and were "buried" by being relegated to the SAI. Indeed, protecting against such location-based litigation arguments is the primary reason funds often set forth relatively expansive lists of primary risks in their statutory prospectus – so as not to be faulted after the fact for "burying" in the SAI a risk that later comes to fruition.

While the Commission's goal of a more readable and concise statutory prospectus is laudable, it should not come at the expense of exposing funds and others to such meritless arguments in litigation.[126]

Ordering of Risks

Requiring funds to "disclose principal risks in order of importance, with the most significant risks appearing first" suggests that funds can ascertain a degree of precision even though risks may be difficult to distinguish among based on importance (*e.g.,* is credit risk or interest rate risk more significant for a bond fund?).[127] Even if that exact calculus was possible at a particular point in time, the importance of any risk may change over time because of market dislocations or other developments. Also, because funds would be instructed to disclose *principal* risks in the first instance, there is less reason to also require funds to rank those risks. Accordingly, we strongly oppose the Commission adopting such a requirement.

We also strongly oppose the Commission prohibiting funds from listing risks in alphabetical order. Today, even in the absence of such an instruction, the staff routinely expresses its view through the disclosure review process that funds should not list risks in alphabetical order.[128] We

[126] We recommend that at a minimum, if the Commission adopts the proposed change, that any adopting release include guidance clarifying that the categorization of principal and non-principal risks—and the allocation of those risks between the statutory prospectus and SAI—is not intended to alter the total mix of information available to shareholders or otherwise affect how courts should assess fund disclosures for purposes of shareholder litigation. In particular, non-principal risks set forth in the SAI should be considered part of the total mix of information available to investors, regardless of whether that information is expressly incorporated by reference in the summary or statutory prospectus and regardless of whether the SAI is delivered to shareholders.

[127] Likewise, in what order should equity funds list market risk, credit risk, and risks associated with a particular portfolio security? These arguably are risks that all equity funds present, and it is not possible to rank them in a meaningful way. Members also expressed concern that they would be between "a rock and a hard place" if this requirement is adopted, and the disclosure review staff, as they may do today, insists that the registrant reorder the risks consistent with the staff's preference. This scenario is of particular concern if the comment relates to an initial registration statement that the staff must declare effective.

[128] *See, e.g.,* Accounting Disclosure Release 2019-08, Improving Principle Risks Disclosure, *available at* https://www.sec.gov/investment/accounting-and-disclosure-information/principal-risks/adi-2019-08-improving-principal-risks-disclosure

understand that some funds do not make the requested change; some funds do (particularly if the comment is on an initial registration statement that must be declared effective); and other times (but not typically) the fund and the staff agree on a compromise approach (*e.g.,* the fund will disclose the most significant three, five, or some other agreed-upon number of risks first, with the remaining risks provided in alphabetical order). The varied approaches are not surprising, given the dynamic nature of risks and any related disclosure.

The Commission taking a more principles-based approach would be consistent with its August 2020 amendments to Regulation S-K.[129] In fact, in the adopting release, the Commission clearly stated its view on the appropriateness of allowing registrants to determine how to best design its risk disclosure, stating that,

> [t]he final amendments will not require registrants to prioritize the order in which they discuss their risk factors. Although we recognize that such prioritization could be useful to users of the disclosure in certain circumstances, consistent with our goal to make the item more principles based, we believe the amendments should afford registrants flexibility to determine the order to most effectively present the material risks that make an investment in the registrant or offering speculative or risky. Accordingly, if a registrant believes it is useful or important to emphasize the relative importance of certain risks, it is free to write those risk factors and other disclosures in such a way that their relative importance is apparent. Retaining this flexibility should also help address concerns expressed by some commenters that it could be difficult to evaluate and rank often equally significant and evolving risk factors.[130]

We urge the Commission to apply this same reasoned approach to fund risk disclosure as it has for public companies. We provide form instructions to implement the recommended change in Appendix D to this letter.

To facilitate readability and comparability among funds, the Commission could encourage funds to employ certain organizational techniques. This would facilitate clear presentation of information. For instance, if a fund endeavors to describe its principal risks in order of importance, the Commission could instruct funds to consider including disclosure something along the lines of the following:

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[129] *See Modernization of Regulation S-K Items 101, 103, and 105*, SEC Release Nos. 33-10825, 34-89670 (August 26, 2020) ("Regulation S-K Release"), *available at* https://www.sec.gov/rules/final/2020/33-10825.pdf (where the Commission indicated that "where appropriate, [a registrant] provide under the caption "Risk Factors" a discussion of the material factors that make an investment in the registrant or offering speculative or risky. This discussion must be organized logically with relevant headings and each risk factor should be set forth under a subcaption that adequately describes the risk. The presentation of risks that could apply generically to any registrant or any offering is discouraged, but to the extent generic risk factors are presented, disclose them at the end of the risk factor section under the caption "General Risk Factors."

[130] Regulation S-K Release at 77.

> The Fund has made a good faith effort to describe its principal risks in order of importance below. Precise quantitative or qualitative ranking of risks may not be possible, and risks are subject to change. Some of the Fund's risks (including those not listed below) therefore may be more prominent in certain market environments and may vary in the extent to which they may adversely affect performance. An investor should consider risks in their totality when evaluating whether to invest in the Fund.

In the event that the Commission ultimately determines to require funds to list principal risks in the summary portion of the statutory prospectus in the order of importance, with the most significant risks appearing first, and regardless of what means funds use to determine the relative significance of principal risks, the fact remains that lower-ranked principal risks could come to fruition and negatively affect fund performance. In that circumstance, shareholder litigation might result, and plaintiffs could be expected to allege that the fund's disclosures were misleading because the risks that caused shareholder losses were "minimized" or "de-emphasized" by being ranked relatively lower in significance. Here again, protecting against such litigation arguments is the primary reason funds often list risks alphabetically or by topic—and specifically avoid rank ordering by significance—so as not to be faulted later for misleadingly minimizing a risk that later comes to fruition. We understand the Commission's concern with ensuring that the most significant risks are brought to shareholders' attention, but addressing that concern should not come at the expense of exposing funds and others to such meritless arguments in litigation.[131]

Mandatory Risk Ratings and Quantitative Risk Metrics Generally

The SEC's Retail Investor Experience Release included questions on matters not expressly addressed via proposed new requirements in this release. We strongly support the SEC's decision *not* to pursue two ideas explored in that release—mandatory use of risk ratings and other quantitative risk measures. We explain our views on this subject further in Appendix C.

[131] If the Commission adopts the requirement as proposed, at a bare minimum, we recommend that the Commission include guidance in any adopting release clarifying that such ordering is not intended to alter the total mix of information available to shareholders or otherwise affect how courts should assess fund disclosures for purposes of shareholder litigation. In particular, all disclosed risks should be considered part of the total mix of information available to investors, regardless of where they fall in the rank ordering.

VII. Miscellaneous Comments

Fund Advertising Rule Amendments

The proposal would amend the SEC's investment company advertising rules[132] to "promote transparent and balanced presentations of fees and expenses in investment company advertisements."[133]

We appreciate that the SEC has modeled the proposed amendments to Rule 482 (and, by reference, Rules 34b-1 and 433) on FINRA Rule 2210(d)(5), which requires similar fee and expense information in retail communications (*e.g.*, advertisements)[134] and correspondence that present non–money market fund open-end fund performance data. These funds are well-versed in providing this fee and expense information in their retail communications.

However, the proposed amendments would not just mirror the FINRA provisions—they would overlap with them to a considerable degree, while also extending beyond the FINRA rule's scope in certain key respects. For instance, whereas the FINRA rule does not subject institutional communications[135] to specific fee and expense provisions, Rule 482 as amended would. FINRA Rule 2210 distinguishes between retail and institutional communications and imposes differing content standards on each. This permits greater flexibility for communications aimed at sophisticated institutional investors and more carefully prescribed content standards for those communications provided to retail investors, who require greater protection. We do not believe that expanding the reach of these fee and expense provisions as the SEC proposes is necessary or warranted.

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[132] The proposed amendments to Securities Act Rule 482 (Advertisements By an Investment Company as Satisfying Requirements of Section 10) would require fund fee and expense presentations in advertisements to include timely and prominent information about a fund's maximum sales load (or any other nonrecurring fee) and gross total annual expenses, based on the fund's prescribed methods of computation. Investment Company Act Rules 34b-1 (Sales Literature Deemed to be Misleading) and Securities Act Rule 433 (Conditions to Permissible Post-Filing Free Writing Prospectuses) would be amended to subject registered fund or BDC sales literature and registered closed-end fund and BDC free-writing prospectuses that include fee and expense information to these new provisions of Rule 482. The proposed amendments to Securities Act Rule 156 (Investment Company Sales Literature) would provide factors a fund should consider to determine whether representations in its advertisements about fund-related fees and expenses could be misleading (*e.g.*, by omitting necessary or appropriate information).

[133] Release at 321.

[134] FINRA Rule 2210(a)(5) defines "retail communication" broadly to mean "any written (including electronic) communication that is distributed or made available to more than 25 retail investors within any 30 calendar-day period."

[135] FINRA Rule 2210(a)(3) defines "institutional communication" as "any written (including electronic) communication that is distributed or made available only to institutional investors but does not include a member's internal communications."

Similarly, we believe that the proposed amendments to Rule 156 are unnecessary. That rule already broadly proscribes the "use [of] sales literature which is materially misleading in connection with the offer or sale of securities issued by an investment company." And FINRA Rule 2210 requires that *all* communications be based on principles of fair dealing and good faith, be fair and balanced, and provide a sound basis for evaluating the facts in regard to any particular security; the rule prohibits omissions of any material fact or qualification if the omission, in light of the context of the material presented, would cause the communications to be misleading.[136] We are also concerned that this proposed amendment could be read to require funds to include even *more* fee and expense information in their sales literature than they provide in their prospectuses (*e.g.*, transaction cost information and costs related to securities lending).[137]

We therefore recommend that the SEC not adopt the proposed amendments because the current robust SEC advertising rules and FINRA Rule 2210 more than suffice to inform investors of the fees and expenses of investing. FINRA Rule 2210—which broadly covers communications concerning all registered funds and BDCs—provides a more appropriate means of regulating fund advertisements and sales literature with respect to fees and expenses than the SEC's advertising rules, which in this case would apply in an overly broad manner, particularly with respect to institutional communications. To the extent that the SEC believes that existing FINRA requirements are insufficient, it could work with FINRA to expand coverage in more tailored ways that recognize the fundamental differences between retail and institutional communications.

<u>Delivery of Section 19(a) Notices</u>

Many ICI members long have expressed concerns with the costs to deliver Section 19(a) notices to fund shareholders. We describe below an alternative approach to delivery to reduce costs. Section 19(a) of the Investment Company Act generally prohibits a fund from making a distribution from any source other than the fund's net income, unless that payment is accompanied by a written statement that adequately discloses the source or sources of the payment. Rule 19a-1 specifies the information required to be disclosed in the written statement ("Rule 19a-1 Notice"). Rule 19a-1(a) also states that every written statement "shall be made on a separate paper."

The Division of Investment Management issued guidance in 2013, stating that:

> Notwithstanding the rule's provision referencing "a separate paper," the staff believes that electronic delivery of a Rule 19a-1 Notice, consistent with the Commission's guidance [on electronic delivery], would satisfy the purposes and policies underlying

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[136] FINRA Rule 2210(d)(1)(A).

[137] If the SEC moves forward with the proposed amendments to Rule 156, it should emphasize in related guidance that the new provision does not (i) preclude a fund from omitting *non-material* information related to fees and expenses from sales literature; and (ii) require that sales literature include disclosures that funds do not presently include in their prospectus fee table presentations.

> Rule 19a-1. Moreover, electronic delivery may be a more efficient, effective and timely means of providing fund shareholders with the required information.[138]

This means that funds may deliver a Rule 19a-1 Notice in the form of an email to the fund shareholder containing the Rule 19a-1 Notice or a document link to the Rule 19a-1 Notice, provided the shareholder has consented to e-delivery.

Despite the step the staff took to modernize delivery, members report that costs associated with producing and delivering paper Rule 19a-1 Notices still can exceed one million dollars annually.[139] The objective of Section 19(a) can be achieved by requiring funds to disseminate information about the sources of distributions required by Rule 19a-1 on the fund's or an affiliate's website within a reasonable amount of time after a distribution is made. Under our recommended approach, funds would be required to inform shareholders that distribution source information is available on a particular website. Specifically, funds would be required to disclose in each annual and semiannual shareholder report that the distribution source information required by Rule 19a-1 is available at a specified website address. To afford shareholders adequate notice that distribution source information will be transitioned from paper delivery to the internet, the Commission could require a one-year transition period. For example, the Commission could require fund shareholder reports to disclose for a specified period that the distribution source information will be available on a website (rather than in paper) after a specified period.[140]

We recommend that this manner of delivery would be optional so that funds could continue to email Rule 19a-1 Notices to shareholders that have consented to that manner of delivery. We

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[138] *See Shareholder Notices of the Sources of Distribution—Electronic Delivery*, SEC Division of Investment Management Guidance Update No. 2013-11 (November 2013), *available at* https://www.sec.gov/divisions/investment/guidance/im-guidance-2013-11.pdf. *See also* SEC No-Action Letter to ICI (pub. avail. July 22, 1996) (permitting funds to inform shareholders of the source(s) of distributions on, or together with, quarterly account statements if the distributions are automatically reinvested in fund shares or are directed to a bank or brokerage account or to a third party or on a check stub for funds that pay distributions by check). Members have informed us that, as a practical matter, only direct-sold, not broker-sold funds, can take advantage of the 1996 no-action relief. Brokerage account statements have limited space, and it would be a lengthy and challenging process with an uncertain outcome for funds to work with brokers to modify the format of their statements. It similarly would be difficult to convince brokers to mail a separate Section 19(a) Notice together with brokerage statements.

[139] The costs include printing, mailing, processing fees, and filing fees.

[140] Unlike mutual fund shareholders, closed-end fund shareholders that purchase shares in the secondary market do not receive the fund's prospectus upon or closely following investment. Therefore, closed-end funds would disclose the availability of 19(a) notices through shareholder reports.

recommend that funds also be required to keep their Section 19(a) Notices on the website for 24 months.[141]

Compliance Dates

We strongly recommend that the Commission, at a minimum, extend the compliance period from 18 to 24 months. The proposal would require funds to make wholesale changes to their entire disclosure regime, altering the primary manner that funds use today to communicate with their shareholders. Any final rules will require considerable investor and intermediary education.

The Commission should not underestimate the significance of the changes the proposal contemplates. When the Commission adopted Rule 498, the summary prospectus rule, it provided funds with approximately two years to comply.[142] There, funds had to revamp the content of, and processes associated with delivering, their statutory and summary prospectuses. In comparison, if the proposal is adopted without change, funds will be tasked with changing the content of, and processes associated with, shareholder reports, Form N-CSR, and prospectuses if they choose to rely on 498B. This is a much more complex set of changes.

The range of proposed changes and their interconnectedness will require funds to carefully coordinate a multitude of personnel and functions within, and outside of, a fund complex. Updating disclosure will require collaboration across multiple firm functions, including fund accounting, operations, legal, compliance, information technology and with counsel, financial printers, prospectus content vendors, financial intermediaries, fund administrators, insurance companies, employee benefit plans, recordkeepers, and software/systems vendors.

Moreover, fund complexes will need ample time to implement, and test, the changes before they can confidently incorporate them into the disclosure preparation workflow. They also will need to dedicate significant time, effort and expense to modifying websites and developing disclosure templates that are accessible, consistent with the Americans with Disabilities Act.

Further, the optional nature of certain key aspects will require funds to conduct a complex cost benefit analysis to determine, in the first instance, whether they should rely on the optional portions of the framework. To further complicate matters, this analysis may depend on the reactions of third parties, such as financial intermediaries and mail houses, to the fund's choices.

[141] Commission exemptive orders that permit closed-end funds to use managed distribution plans often require that funds maintain Rule 19a-1 Notices on their website for at least 24 months. Rule 19a-1 Notices provide estimated information for shareholders. Once a calendar year is complete, however, information on a shareholder's Form1099 DIV supersedes any estimated information reported on the Rule 19a-1 Notices. The Form 1099 information could be quite different from the estimates provided in the Rule 19a-1 Notices and could cause confusion and improper tax reporting from investors if they incorrectly use the information within the Rule 19a-1 Notices. This could be addressed by disclosing on the fund's website the relationship between the 19a-1 Notice and the Form 1099.

[142] *See* Summary Prospectus Release, *supra*, note 36.

Finally, the additional time will be important given that firms are ascertaining how to deploy resources to implement recently adopted rules for fund of funds, derivatives, and fair valuation. They will have to factor this into how to allocate resources necessary to implement any disclosure reform.

* * * * *

We support improving disclosure for fund shareholders and look forward to assisting the Commission in any way as it continues to consider this important issue. If you have any questions, please contact the undersigned respectively at [redacted] or [redacted] You also may contact Greg Smith, Senior Director, Fund Accounting & Compliance at [redacted] Matt Thornton, Associate General Counsel at [redacted]

Regards,

Susan Olson, General Counsel
/s/

Dorothy Donohue, Deputy General Counsel, Securities Regulation
/s/

cc: The Honorable Jay Clayton
The Honorable Hester M. Peirce
The Honorable Elad L. Roisman
The Honorable Allison Herren Lee
The Honorable Caroline Crenshaw

Division of Investment Management
Dalia Blass, Director
Paul Cellupica, Deputy Director and Chief Counsel
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Amanda Wagner, Branch Chief

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Appendix A: ICI's Proposed Framework for Delivering Fund Materials

To better serve investors' preferences, we recommend that the SEC change the default for e-delivery of fund materials from opt-in to opt-out and describe our recommendations more fully below.

- ***Existing Investors Who Currently Elect E-Delivery.*** Investors who currently receive fund materials via e-delivery would continue to do so. There would be no change for these investors.

- ***Existing Investors Who Currently Elect Paper Delivery and an E-Delivery Address Is Available.*** Existing investors who currently receive paper but previously have provided their email address or smartphone contact information, would automatically begin receiving communications electronically at the end of the transition period unless they have affirmatively requested paper.[143] The investor would be informed that the fund will use the email address on file (which the fund will identify) to send all future disclosure documents to the investor unless the investor elects otherwise or informs the fund to use a different email address.

- ***Existing Investors Who Currently Elect Paper Delivery and an E-Delivery Address Is Not Available.*** Existing investors who currently receive paper and have not previously provided their email address or smartphone contact information would receive notification during the transition period of the new electronic delivery method and a request to provide at least one e-delivery address. An investor who does not provide an e-delivery address would continue to receive disclosure documents via paper delivery.

[143] Consistent with a recent SEC staff statement, Staff Statement Regarding Temporary International Mail Service Suspensions to Certain Jurisdictions Related to the COVID-19 Pandemic (June 24, 2020), *available at* https://www.sec.gov/tm/temporary-international-mail-service-suspension, we recommend that funds be provided the flexibility to use reasonable best efforts to timely deliver documents electronically using contact information for the shareholder (*e.g.*, an email address) that the fund has a reasonable basis to believe is current and, in the transmittal message, explain why the fund is delivering such documents electronically.

The statement also noted that "if the email bounces back for some reason, the Commission should permit the fund to use reasonable best efforts to obtain current contact information for electronic delivery of such documents to the shareholder (*e.g.*, through commercially available resources)." ICI members are not aware of any such available resources.

- ***Flexible Delivery Method.*** The SEC would not mandate that the information be conveyed in a "notice." Rather, funds would be free to choose the manner of informing shareholders, similar to the SEC's approach in the proposal.[144]

- ***New Investors.*** All new investors, including investors who open new accounts on paper applications, would be informed that they will be enrolled automatically in e-delivery when they provide an e-delivery address. The account opening statement would request an e-delivery address. The account opening statement also would include a field permitting fund investors to indicate their consent to receive information directly from the funds even when fund shares are held in a brokerage account.

- ***Ongoing Changes to Delivery Elections.*** An investor would be permitted to change delivery elections at any time for all disclosure documents or for certain disclosure documents. The available methods to change elections could include contacting the fund electronically or telephonically by using a toll-free number (or by contacting his or her financial intermediary).

- ***Transition Period.*** The SEC should provide funds a transition period of one year to notify investors who currently receive paper delivery of the change to the new e-delivery method.

[144] *See* Release at 248.

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Appendix B: ICI's Additional Comments on Enumerated Items in Shareholder Report

Shareholder Report Design

Electronic Annual Reports and Accessibility and Presentation Requirements

We strongly support the Commission including instructions that address electronic presentation of information in a manner that would provide funds the flexibility to enhance the usability of reports that appear online or on mobile devices. Doing so will enhance the ability of funds to communicate with their investors in the medium that they prefer. Similarly, we support the Commission providing funds with flexibility to add additional tools and features to annual reports that appear on a website or are otherwise provided electronically, including video or audio messages, mouse-over windows, and pop-ups. This too will permit funds to enhance their communications with investors and recognizes funds' commitment to using electronic media. For example, many funds have invested substantial resources in technology to develop and maintain websites that offer investors and intermediaries a wealth of fund and other investment and market information, educational materials, and interactive features such as expense calculators and retirement planning tools.

We also support the proposed safe harbor provision providing that a fund shall have satisfied its posting obligations even if the required information is not available for a temporary period of time, provided the fund has reasonable procedures in place to ensure the information is available and corrects the situation promptly. This is a sensible approach that mirrors Rule 498's approach to funds' use of summary prospectuses. We also support funds having flexibility as to how present online information.

In considering how to use technology to improve the retail investor experience, it is critical that the Commission not dictate the content or placement of information on fund websites, and strive to maintain technology-neutral requirements. Many fund complexes have voluntarily invested substantial resources in technology to develop and maintain websites that offer investors and intermediaries a wealth of fund and other investment and market information, educational materials, and interactive features such as expense calculators and retirement planning tools. These have been developed in response to specific feedback and testing. in ways that benefit investors, but our members are highly concerned that any new requirements could cause them to have to radically revamp existing systems and formats that were developed with significant study and testing. Such changes would involve substantial costs and run the genuine risk of quickly becoming outdated.

It is essential that the Commission not be prescriptive so funds can best use technology for the benefit of fund investors. Any approach must be flexible enough to allow funds to respond to innovation and change to best serve their investors.

Content Limited to Items Required or Permitted

The proposal would allow a fund to include in its shareholder report only the information that Item 27A specifically permits or requires.[145] A fund may also include information necessary to make the required items not misleading. If a required item is inapplicable, the proposal would permit the fund to omit it. Similarly, a fund would be permitted to modify a required legend or narrative if the modified language contains comparable information to what is otherwise required. We support each of these proposed instructions.

While the proposal would not allow the fund to incorporate by reference information into the shareholder report, it would not prevent a fund from referring shareholders to the availability of additional information on the fund's website. A fund could also provide additional information to shareholders in the same transmission as the shareholder report (*e.g.*, a "president's letter"). The proposal would require the fund to give the shareholder report to be given greater prominence than these other materials.[146] The greater prominence requirement, however, would not apply to specified disclosure materials that a fund may transmit with the shareholder report (*i.e.*, summary prospectuses, statutory prospectuses, notices of availability of proxy materials, and other shareholder reports). We support each of these proposed instructions.

Question 12 in the proposing release asks if there is other information funds typically include in their annual shareholder reports to comply with regulatory requirements. The Internal Revenue Code requires regulated investment companies ("RICs") to report the tax character of certain distributions paid in written statements furnished to shareholders.[147] For most shareholders this requirement is satisfied through delivery of IRS Form 1099-DIV. Corporate and certain other shareholders, however, do not receive Form 1099s and funds frequently include the disclosure in their annual shareholder report as a means of ensuring compliance with the reporting requirement.

ICI has requested clarification from the IRS that RICs can satisfy the written statement requirements by posting dividend information on their public websites.[148] Funds would prefer this method of reporting over including the information in shareholder reports, as they believe it

[145] Proposed Instruction 3 to Item 27A(a) of Form N-1A.

[146] Proposed Instruction 12 to Item 27A(a) of Form N-1A.

[147] IRC 852(b)(3)(C)(1).

[148] *See* Letter from Karen Lau Gibian, Associate General Counsel, Investment Company Institute to Krishna Vallabhaneni, Tax Legislative Counsel, US Department of the Treasury (December 16, 2020) *available at* https://www.ici.org/pdf/32987a.pdf.

is a more efficient means of communicating the information with shareholders. We do not know if the IRS ultimately will grant such guidance. We therefore recommend that funds be permitted to continue to include information related to the tax character of distributions in shareholder reports, as requiring a separate mailing solely to comply with these tax requirements would add unnecessary print and mail costs to funds and their shareholders.

Availability of Additional Information

Funds would be required to include a statement in the report that informs investors about additional information that is available on the fund's website.[149] We support the proposed statement, and the ability for funds to refer to other important information available on the fund's website.

Shareholder Report Content: Item by Item

Annual shareholder reports would be required to include the following items in the order prescribed: i) cover page, ii) fund expenses, iii) management's discussion of fund performance (MDFP), iv) fund statistics, v) graphical representation of fund holdings, vi) material fund changes, vii) changes in and disagreements with accountants, and viii) statement regarding liquidity risk management program. Annual shareholder reports may also include a statement regarding the availability of additional information on the fund's website and a statement explaining how shareholders may revoke their consent to householding.[150] Semiannual shareholder reports would contain the same information except that MDFP and material fund changes would be permitted but not required. While the proposal generally limits the content of shareholder reports to the prescribed items, there are no page or word limits on report length. We address each of these items in turn.

[149] Proposed Item 27A(j) of Form N-1A. Specifically, the statement would reference the fund's prospectus, financial information, holdings, and proxy voting record. If the shareholder report appears on a fund's website or otherwise is provided electronically, the fund must provide a means of immediately accessing that information (such as a hyperlink or QR code). The fund would also be able to refer to other information available on the fund's website, if it reasonably believes that shareholders would find the information important (*e.g.*, a description of credit ratings, additional performance presentations, or additional commentary about how the fund performed).

[150] We support the proposed approach of retaining the provision that permits funds to explain how a shareholder may revoke consent to householding of the annual report. If a fund relies on householding, it must explain to investors who have provided written or implied consent how they can revoke their consent. Funds have found that this to be effective, understandable disclosure.

Cover Page

The cover page or beginning of the shareholder report would be required to include certain specified information.[151] The proposed amendments would allow a fund to include graphics, logos, QR codes, and other design or text features. We support each of the proposed cover page required disclosures, except as discussed directly below.

While proposed Item 27A does not specify that the website in question must be a fund website, the proposing release refers to the address to be provided as a "Fund website address."[152] In addition, the term "us," as used in the phrase "contacting us," is not defined, but could be read to refer to the fund.

For underlying funds of variable insurance products, shareholder reports are delivered to contract holders under Rule 30e-2. The record holders of underlying funds are the insurance company separate accounts that offer the funds as investment options under their variable products, and underlying funds have no visibility or access to contract holders.

Accordingly, we request that that the final rule be revised in a manner that provides flexibility for underlying funds to draft this disclosure as applicable. Flexibility to make such adjustments would be consistent with the approach taken elsewhere in Form N-1A, both in its current form and as proposed to be amended, which recognizes that certain specified disclosures required for retail funds may not be appropriate for underlying funds, and that rigid requirements to use the same language could cause investor confusion. For this reason, Instruction 3.C.(d) of Form N-1A (Modified Prospectuses for Certain Funds) provides that a fund may modify or omit, if inapplicable, the information required by certain items for funds used as investment options for variable contracts, if covered in a separate account prospectus, and that such funds may alter certain legends and modify certain other disclosure in the prospectus consistent with offering the fund under a variable contract.

To implement this recommendation, we recommend that Instruction C.3.(d) be modified by providing underlying funds with the flexibility to draft the references in Item 27A(4) as applicable to reflect how investors may obtain additional information about underlying funds.

Fund Expenses

The SEC proposes a simplified expense presentation that would require the fund to provide the dollar amount of expenses incurred on a hypothetical $10,000 investment during the reporting

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[151] Proposed Item 27A(b) of Form N-1A would require the cover page to include: (i) the fund's name and share classes to which the report relates; (ii) the ticker symbol, and if an ETF, the principal US market on which the fund's shares are traded; (iii) a statement identifying the document as an annual shareholder report or semiannual shareholder report; and (iv) a legend indicating that the shareholder report contains important information about the fund for the reporting period, the website where the shareholder can obtain additional information and a toll-free telephone number where the shareholder can request additional information.

[152] Release at 67.

period based on the fund's actual return.[153] This would replace the currently required presentation based on a $1,000 investment calculated using a) the fund's actual return, and b) an assumed five percent return.

We support the proposed presentation of fund expenses and believe that the simplified presentation will contribute to shareholder understanding of costs paid. We support eliminating the narrative preamble and the expense information based on a hypothetical five percent return in the currently required expense example.

We also support the proposed change whereby the expense example included in the annual shareholder report would cover the twelve-month period (rather than the final six months of the fiscal year). We recommend a technical change to proposed Instruction 2(a) to Item 27A(c), which addresses calculation of the costs paid amount in the tabular presentation, The Commission should modify the instruction to address calculation of costs paid for the six-month semiannual period.[154] We also recommend modifying the instructions so that where the minimum initial investment for a share class is greater than $10,000, the assumed investment at the beginning of the period may reflect the actual higher minimum initial investment.

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[153] Proposed Item 27A(c) of Form N-1A would require the fund, or each share class in a multiclass fund, to provide in tabular format: (i) an assumed $10,000 beginning account value; (ii) total return before costs paid; (iii) costs paid; (iv) ending account value; and (v) costs paid as a percentage of investment (*i.e.*, the expense ratio). ETFs must also include the ending value of the account based on market value return. All amounts would be expressed in whole dollars except for the expense ratio, which would be rounded to the nearest hundredth of one percent. The tabular format would be presented as an equation (*i.e.*, beginning account value plus return before costs paid less costs paid equals ending account value), and the costs paid and expense ratio information would be required to be displayed with greater prominence than the other columns in the table.

The expense ratio used to calculate the costs paid would be the backward-looking expense ratio from the fund's financial statements calculated pursuant to Item 13(a) of Form N-1A (the financial highlights) and as such would exclude investment transaction costs, securities lending costs and AFFE. Funds would be required to describe these costs qualitatively in a footnote to the table, if applicable and material, and note that they are included in the total return before costs paid amount and that they materially reduced total return. Funds would also be required to briefly explain in a footnote to the table that information in the table does not reflect costs associated with purchasing or selling fund shares.

[154] Specifically, we recommend adding "To determine 'costs paid' for the six-month period included in the semiannual report, multiply 'costs paid' as determined in the preceding sentence by (number of days in fiscal half-year/365)" or a similar instruction.

Management's Discussion of Fund Performance (MDFP)

Funds other than money market funds would be required to include MDFP in their annual shareholder reports.[155] The proposal would largely maintain the current requirements for MDFP.[156]

The proposal would make certain changes intended to make MDFP more concise and to reflect that shareholders may no longer receive certain performance information required to be disclosed in the prospectus (assuming the fund relies on proposed Rule 498B).[157] We discuss these proposed changes below.

Narrative MDFP Disclosure

The proposal would amend the requirement to provide a narrative discussion of the factors that materially affected the fund's performance over the reporting period, including the relevant market conditions and investment strategies used by the adviser. Specifically, the proposal would require the fund to "briefly summarize" the "key" factors that materially affected the fund's performance in order to make the discussion more concise. A proposed instruction would direct funds not to include lengthy, generic, or overly broad discussions of factors that generally affected market performance. The proposal would also direct funds to use graphics or text features to present the key factors, as appropriate.

Appendix A to the proposal—the SEC-prepared shareholder report reflecting proposed Item 27A—includes a performance attribution table reflecting top contributors and top detractors from performance by asset class and sector. The proposing release indicates that such analyses by holding, industry, geographic region, or other relevant category may be helpful to shareholders in understanding the fund's performance and that funds could include them in MDFP.

We support the requirement to include a narrative discussion of the factors that materially affected the fund's performance over the reporting period and the proposed changes directing the fund to briefly summarize the key factors. We also support the flexible approach the Commission has proposed permitting funds to use bullet lists, tables, and attribution analyses by

[155] Proposed Item 27A(d) of Form N-1A.

[156] Item 27(b)(7) of Form N-1A requires MDFP, including: (i) a narrative discussion of the factors that materially affected the fund's performance during the fiscal year; (ii) a line graph comparing the value of an initial $10,000 investment over the last 10 fiscal years to an appropriate broad-based securities market index; (iii) a table showing the average annual returns for the past 1-, 5-, and 10-year periods; (iv) an accompanying statement indicating that past performance does not predict future performance and that the presentation does not reflect taxes; (v) a discussion of the effect of any policy or practice of maintaining a specified level of distributions to shareholders on the fund's net asset value and the extent to which the policy resulted in distributions of capital; and (vi) for ETFs that do not provide premium or discount information on their websites, a table showing the number of days the fund shares traded at a premium or discount.

[157] The proposal also would amend the definition of "appropriate broad-based securities market index," our comments on which we provided earlier in the letter.

relevant category as appropriate.

Average Annual Total Returns Table

The proposal would retain the 1-, 5-, and 10-year average annual returns table, subject to several changes: i) the table would be required to include the average annual total returns of an appropriate broad-based securities market index; ii) the table would be required to include average annual returns without sales charges (in addition to currently required disclosure reflecting sales charges); and iii) the table would be required to include average annual total returns for each share class the report covers.

These changes would better align the average annual returns table in the shareholder report with the returns reported in the prospectus. Consistent with the prospectus requirements, the fund could include one or more other relevant indexes in the total return table in addition to the required index. We support these proposed changes to the average annual returns table[158].

Currently funds must include a statement accompanying the line graph and table indicating that past performance does not predict future performance. The proposal would require the statement to be made more prominent through graphics, such as font size, colors, or bolding. Funds would continue to be required to state that the presentation does not reflect taxes that a shareholder would pay on distributions and redemption. We support the statements accompanying the line graph and table and the proposed prominence requirement.

The proposal would add a new instruction indicating that if a material change occurred to the fund during the relevant performance period, such as a change in investment adviser or change in the fund's strategies, the fund may include a footnote to describe the change and when it occurred. We support this discretionary approach enabling the fund to determine when to disclose information about a material change in connection with the performance presentation, because some material changes may not significantly affect a fund's performance.

If the fund provides updated performance on its website, the proposal would require it to include a statement in the report directing shareholders to where they may find the information. If the fund includes such a statement, it would be required to include a hyperlink if the report is in electronic format, or a URL or QR code if the report is in paper. We support the proposed requirement directing shareholders to more current performance information.

MDFP in the Semiannual Shareholder Report

The proposal would permit, but not require, funds to include MDFP in their semiannual shareholder reports. We strongly support the proposed approach. We understand that some funds voluntarily include a MDFP in semiannual shareholder reports but others do not. Members believe the performance commentary annual production schedule remains appropriate, given that

[158] We provided our recommendations regarding the definition of index earlier in the letter.

drafting this disclosure requires significant time and effort of the fund's portfolio manager. This is an appropriate approach, and we are unaware of investors asking for this information to be included in semiannual shareholder reports.

At the same time, we seek clarification that a fund that elects to provide MDFP in its semiannual shareholder report could provide some, but not all, of the information required by MDFP. For example, a fund may wish to provide the line graph comparison, without providing the 1-, 5-, and 10-year average annual returns table with and without sales charges for each class.

We also seek clarification that a fund that elects to provide MDFP in its semiannual shareholder report could include total return performance for the six-month period. For example, a fund may wish to include the total return performance or performance relative to the benchmark for the six-month period in the brief discussion of key factors materially affecting the fund's performance. The fund may also seek to include total return performance for the six-month semiannual period as an additional column in the average annual total returns table providing the 1, 5, and 10-year average annual total returns as of the semiannual period end.

MDFP and Money Market Funds

Currently money market funds are not required to provide MDFP in their annual shareholder reports.[159] Money market funds may, however, provide investors with a discussion of their performance, including illustrative line graphs.[160]

The proposal similarly would not require money market funds to provide MDFP. The proposal requests comment on whether the Commission should require some or all money market funds to include performance information in their shareholder reports (*e.g.*, 7-day yield, average annual total returns table, and performance bar chart).

We recommend that the SEC clarify that money market funds are permitted, but not required, to provide (i) MDFP in their shareholder reports, and (ii) some, but not all the required MDFP disclosures. For example, a money market fund may wish to omit the discussion of key factors that materially affected the fund's performance over the reporting period, including investment strategies and techniques used by the fund's adviser. Given the risk-limiting conditions of Rule 2a-7, this would be a reasonable approach and therefore should be permitted.

[159] Item 27(b)(7) of Form N-1A.

[160] *Disclosure of Mutual Fund Performance and Portfolio Managers*, SEC Release Nos. 33-6988; IC-19382 (April 6, 1982), at 15-16, *available at* https://www.sec.gov/rules/final/33-6988.pdf.

Fund Statistics

The proposal would require a new Item in shareholder reports—fund statistics—intended to help shareholders better understand the fund's operation during the reporting period.[161] Generally, funds would be precluded from including information in their shareholder reports beyond that which Item 27A specifically permits or requires. A fund may, however, include additional statistics beyond the three required metrics, but only if they are reasonably related to the fund's investment strategy.[162] The proposal cites as examples of additional statistics tracking error, maturity, duration, average credit quality, and yield.

We support the proposed fund statistics requirement, including the requirement that any additional optional statistics presented be reasonably related to the fund's investment strategy. We recommend that the SEC affirm that other statistics, beyond those cited in the proposing release, should be deemed reasonably related to the fund's investment strategy, including information on the fund's portfolio or the portfolio relative to the fund's benchmark index, such as average market capitalization, average price/earnings ratio, and average earnings growth rate, beta, r-squared and similar measures.

If a fund statistic changed significantly during the most recent fiscal year, we recommend the fund be permitted to briefly describe the factors that contributed to the change. We also recommend that money market funds be exempt from the requirement to disclose portfolio turnover in the statistics section in their shareholder reports. Not requiring money market funds to calculate and disclose portfolio turnover as part of the financial highlights table is the most sensible approach, given that most of their securities mature in one year or less.[163] This would be consistent with how money market funds present their financial highlights table today.

Changes in and Disagreements with Accountants

Currently funds are required to disclose in the shareholder report information concerning changes in and disagreements with the independent auditor.[164] The disclosure is intended to inform shareholders about the circumstances surrounding any change in the fund's auditor.[165]

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[161] Proposed Item 27A(e) of Form N-1A would require funds disclose: (i) net assets; (ii) the total number of portfolio holdings; and (iii) the portfolio turnover rate as of the end of the reporting period.

[162] Proposed Instruction 5 to Item 27A(e) of Form N-1A. If a fund provides a statistic that is otherwise described in Form N-1A, it must follow any associated instructions describing the calculation method for the statistic (*e.g.*, SEC yield). If a fund provides a statistic that is included in or could be derived from the fund's financial statements or financial highlights, the fund must use or derive the statistic from the fund's most recent financial statements or financial highlights. A fund would be permitted to briefly describe the significance or limitations of any disclosed statistics in a parenthetical or footnote or similar presentation.

[163] Instruction 4(c) to Item 13(a) of Form N-1A.

[164] Item 27(b)(4) of Form N-1A.

[165] Item 304 of Regulation S-K.

Specifically, funds must disclose whether there were any accounting or auditing-related disagreements that caused the auditor to be dismissed or resign. The required disclosures are quite lengthy, but their occurrence is infrequent.

The proposal would move the disclosure to Form N-CSR and require the shareholder report to include a high-level, plain English summary of the information included in Form N-CSR.[166]

We support the proposed plain English summary as proposed. We believe changes in auditors are significant and that they warrant disclosure in the shareholder report, particularly where there were accounting or auditing-related disagreements.

Additional Comments on Form N-CSR

Financial Statements

The proposal would eliminate the ability to provide a summary schedule of investments (listing the top 50 holdings and any other investment exceeding one percent of net asset value) in the shareholder report.[167] Instead, the fund's complete schedule of investments would appear in Form N-CSR and online. Accordingly, we support elimination of the summary schedule of investments.

Financial Highlights

The proposal would modify the financial highlights table to require an ETF to disclose, in addition to total return based on NAV per share, its total return based on market price per share as of the end of the period.[168] Total return based on market price per share would be used to calculate ending account value in the proposed shareholder report expense example. We support the proposed change to the financial highlights table.

Compensation Paid to Directors and Officers

Currently funds must disclose compensation paid to directors and officers in the annual shareholder report, unless that information is disclosed as part of the financial statements.[169] The compensation disclosure would be moved to proposed Item 10 of Form N-CSR. That item,

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[166] Proposed Item 27A(h) of Form N-1A would require (i) a statement of whether the auditor resigned, declined to stand for re-election, or was dismissed and the date; and (ii) a brief plain English description of any disagreement. Funds would not be required to disclose the absence of disagreements.

[167] The summary schedule of investments was intended to shorten shareholder reports and focus investors on the fund's most significant holdings. Because the schedule of investments would no longer appear in shareholder reports, the option to use a summary schedule of investments is no longer apt.

[168] Instruction 3 to Proposed Item 13(a) of Form N-1A.

[169] Item 27(a)(3) of Form N-1A.

however, omits the phrase "unless that information is disclosed as part of the financial statements" and would seemingly require a response to proposed Item 10 even where the compensation information is disclosed in the financial statements. To avoid redundancy and minimize burden, we recommend inserting the phrase "unless that information is disclosed as part of the financial statements included at Item 7" in proposed Item 10.

Statement Regarding Basis for Approval of Investment Advisory Contract

Currently Item 27 of Form N-1A requires funds to include in the shareholder report a statement regarding the basis for approval of the fund's investment advisory contract. The statement would be moved to proposed Item 11 of Form N-CSR. Instruction 3 to proposed Item 11 includes a cross-reference to "paragraph (d)(6)(i) of this Item" that was inappropriately copied from existing Item 27 of Form N-1A. We therefore recommend changing the cross-reference in Instruction 3 to "paragraph 1 of this Item."

Proposed Website Content Requirements

All the information that the proposal would move to Form N-CSR would be required to be available on the fund's website not more than 70 days after the end of the fiscal half-year or fiscal year.[170] That information would remain on the fund's website until 70 days after the next respective period end.

In addition, a fund, other than a money market fund, would be required to post its complete portfolio holdings as of the end of its first and third fiscal quarters not more than 70 days after quarter end and keep it available online for one year. This would result in complete portfolio holdings information as of the four most recent quarter ends being available on the fund's website. The portfolio holdings presentation would be required to comply with Regulation S-X.

We support the proposed website posting requirements relating to proposed Items 7 – 11 of Form N-CSR; the proposed 70-day deadline for posting information to the fund's website (it comports with the existing SEC filing deadline for Form N-CSR in Rule 30b2-1); and the proposed one-year period during which the information must remain available on the fund's website.

Delivery Upon Request

The proposal would require a fund to send to any person a paper copy of proposed Items 7 – 11 of Form N-CSR upon request at no charge by first-class mail or other reasonably prompt means with three business days after receiving the request.[171] Similarly, the fund would be required to send the materials to any person requesting an electronic copy at no charge within three business days after receiving the request. For the reasons previously discussed, we recommend replacing

[170] Proposed Rule 30e-1(b)(2)(i).

[171] Proposed Rule 30e-1(b)(3).

the three-business-day requirement with an "as soon as reasonably practicable but no later than fourteen business days" requirement.

We also note that proposed changes to Item 1 of Form N-1A would impose a new obligation to deliver Form N-CSR to shareholders upon request within three business days after receiving the request at no charge by first-class mail. In contrast to the proposed delivery requirement in Rule 30e-1, Item 1 of Form N-1A appears to require the entire Form N-CSR to be delivered to shareholders upon request. We believe much of the information in Form N-CSR is of little or no interest to shareholders (*e.g.*, audit fees paid, Sarbanes-Oxley certifications, *etc.*). Still other information in the Form N-CSR would have already been previously delivered to shareholders (*i.e.*, the Item 1 shareholder report). We recommend that both Rule 30e-1 and Form N-1A require delivery upon request of only Items 7 – 11 of Form N-CSR (*i.e.*, those items that are being omitted from the shareholder report).

Management Information Table

Funds are currently required to include in their annual shareholder report information about the fund's directors and officers.[172] The management information table identifies the fund's directors and officers by name, including their address, age, position, length of service, and principal occupation for last five years. The same information must also be disclosed in the fund's SAI.[173]

The proposal would omit this table from the annual shareholder report and would *not* require it to be filed in Form N-CSR. We support the omission of the management information table from the proposed shareholder report and agree that it need not be filed in Form N-CSR so long as it is a required disclosure item in the fund's SAI.

Additional Comments on Prospectus Disclosure

Funds of Funds

Proposed Instruction 2 to Item 9(c) is addressed to a fund investing in other funds (an "acquiring fund" and an "acquired fund," respectively), commonly known as a "fund of funds."

The Commission has observed that many acquiring funds disclose all of the principal risks of each of their acquired funds as part of their principal risk disclosure. In some cases, acquiring funds list over 70 principal risks. The proposed instruction states that, in the case of acquiring funds, risks should be included only if they are principal risks of the *acquiring* fund, and that a principal risk of an acquired fund should not be included unless it is a principal risk of the acquiring fund. We support the proposed change.

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[172] Item 27(b)(5) of Form N-1A.

[173] Item 17(a)(1) of Form N-1A.

Go Anywhere Funds

We support the Commission requiring any fund with a go anywhere strategy (*i.e.*, a strategy that permits the manager discretion to invest in different types of assets) to disclose that an investor may not know—and has no way to know—how the fund will invest in the future and the associated risks.[174]

[174] Proposed Instruction 3 to Item 9(c) of Form N-1A.

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Appendix C: ICI's Views on Mandatory Risk Ratings and Mandatory Quantitative Metrics

The 2018 release asked several questions about risk disclosure, including whether (i) a standardized risk measure or risk rating would be useful to understand a fund's risk, and (ii) funds should disclose one or more quantitative measures of risk (*e.g.*, historic volatility, standard deviation, Sharpe ratio). ICI's comment letter strongly opposed both ideas,[175] and this continues to be our view. Risk is inherently complex, multi-faceted, and variable, and therefore no single, comprehensive, and agreed-upon standard measure of fund risk exists. This is readily apparent by reviewing the narrative principal risk disclosures in funds' prospectuses, which generally include several enumerated risks for each fund and differ widely by fund type. Investors view and weigh risks very differently depending on their specific investment objectives and subjective preferences.

For instance, an investor with a short-term savings objective (*e.g.*, holding assets to fund a home purchase in the near future) will place great emphasis on minimizing principal volatility. For this purpose, a money market fund would be much more appropriate than an equity fund. Conversely, this same investor also may have a parallel long-term savings objective (*e.g.*, saving for retirement) and likely will place much less emphasis on volatility risk and comparatively greater emphasis on longevity or shortfall risk (*i.e.*, the risk of outliving one's assets) and inflation risk (*i.e.*, the risk that the purchasing power of one's assets will erode over time). For this purpose, an equity fund would be much more appropriate than a money market fund. Thus, whether the money market fund or the equity fund is more or less "risky" depends significantly on the *specific* risk (or combination of risks) germane to the investor's objective and subjective preferences. And any attempt to create "risk rating" system and require fund disclosure of any such ratings (or disclosure of a measure like standard deviation) could be confusing and misleading and impair investors' ability to make sound decisions specific to their preferences and objectives. Finally, the experiences of the European Union and Canada demonstrate the hazards of regulators imposing standardized risk measures.

[175] *See* ICI Retail Investor Experience Letter, *supra*, note 10 at 5, 38-45, and Appendix D.

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Appendix D: Rule Text to Implement Recommended Approach to Prospectus Risk Disclosure

(based, in part, on Regulation S-K, Item 105)

Form N-1A

(b) **Principal and Certain Other Risks of Investing in the Fund.**

(1) Narrative risk disclosure.

(i) Based on the information given in response to Item 9(c), briefly summarize the principal risks of investing in the Fund, including the risks to which the Fund's portfolio as a whole is subject and the circumstances reasonably likely to affect adversely the Fund's net asset value, yield, and total return. Unless the Fund is a Money Market Fund, disclose that loss of money is a risk of investing in the Fund.

Instructions.

1. A Fund may, in responding to this Item, describe the types of investors for whom the Fund is intended or the types of investment goals that may be consistent with an investment in the Fund.
2. This discussion must be organized logically with relevant headings and should include subcaptions, as appropriate.
3. A Fund may briefly describe its organizational approach to presenting risk information and any limitations thereto. For instance, if a Fund endeavors to describe its principal risks in order of importance, it may include an introductory paragraph noting, among other things, that:
    a. a precise quantitative or qualitative ranking of risks may not be possible;
    b. risks are subject to change and therefore some of the Fund's risks may be more prominent in certain market environments, and may adversely affect performance to varying degrees;
    c. the Fund ordered its risks using good faith efforts as of the date of the prospectus;
    d. the Fund may not necessarily re-order such risks during the course of the year; and
    e. an investor should consider risks in their totality (including those described elsewhere in the prospectus and SAI) when evaluating whether to invest in the Fund.
4. If a Fund presents risk factors in alphabetical order, it should state that it is doing so.
5. The Fund must provide this information in plain English.