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Via Electronic Filing

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

RE: Tailored Shareholder Reports (Release Nos. 33-10814; 34-89478; IC-33963; File No. S7-09-20)

Dear Secretary Countryman:

The Cornell Securities Law Clinic ("Clinic") submits this comment letter in support of the proposal ("Rule Proposal") to enact new rule 498B 1 [proposed rule 17 CFR 230.498B] under the Securities Act of 1933 ("Securities Act").[1] The Clinic is a Cornell Law School curricular offering in which law students provide representation to public investors and public education as to investment fraud in the largely rural "Southern Tier" region of upstate New York. For more information, please see: https://www.lawschool.cornell.edu/Clinical-Programs/securities-law-clinic/index.cfm.

As explained in greater detail below, the Clinic supports the amendments contained in the Proposal as a timely, important step in providing retail investors with the information they need to make informed decisions with respect to mutual funds and exchange-traded funds (collectively, "funds").

I. The Clinic Supports the SEC's Intention to Restrict the Content of Shareholder Reports.

[1] 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) ("Release"), available at https://www.sec.gov/rules/proposed/2020/33-10814.pdf.

The SEC proposes adding new Item 27A to Form N-1A.[2] This addition would specify the design and content of funds' annual and semi-annual reports to make such reports the central source of disclosure for existing shareholders.[3] Additionally, the proposed changes would limit a fund's discretion to provide information not explicitly permitted within the shareholder report.[4] The SEC has made an explicit request for comment regarding this latter limitation.[5]

The Clinic supports the SEC's proposal to restrict the content of shareholder reports to the confines of Item 27A of Form N-1A.

In the view of the SEC, limiting the informational content of shareholder reports would (1) promote consistency of information presented to shareholders, (2) allow retail investors to focus on information relevant to the monitoring of their investment, and (3) encourage impartiality of information by disallowing fund marketing material.[6]

In the view of the Clinic, these objectives are consonant with the SEC's overall objective of improving the experience and protecting the interests of retail investors.[7] Promoting consistency of information in shareholder reports would likely foster retail-investor literacy.[8] Allowing investors to focus on a smaller amount of information would increase the likelihood of investors actually seeing information relevant to the monitoring of their investment.[9] And encouraging impartiality of information would increase investors' opportunities to read through the shareholder report in a level-headed manner.

On the other hand, one might worry that sweeping restrictions on the content of shareholder reports could lead to omissions of material information. For example, a fund might try to omit material information not specifically covered under Form N-1A so as to mislead investors. Alternatively, a fund might leave out material information reasonably believing that they were required to do so.

Such concerns would be misplaced here.

First, the proposed changes would enable funds to communicate supplementary information to investors in Form N-CSR.[10] Second, the proposed changes to Form N-1A include a catch-all requirement: funds must disclose all material changes to the fund.[11] Thus, the proposed restrictions on shareholder-report content would not prevent a fund from conveying

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[2] Release at 48.
[3] The item would also remove provisions in current Item 27 of Form N-1A relating to annual and semi-annual reports. *See* Release at 49–50.
[4] Release at 51.
[5] Release at 59.
[6] Release at 56.
[7] *See* Release at 1.
[8] *See* comment letter by Christine Zhu (Sep. 29, 2020). Available at: sec.gov/comments/s7-09-20/s70920-7860079-223917.pdf. *See also* deHaan, Song, and Zhu (2020). "Obfuscation in Mutual Funds." Available at SSRN: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3540215.
[9] *Id.*
[10] Release at 48.
[11] Release at 49.

material information to investors, nor would it serve as an excuse for intentionally withholding such information. While the SEC's use of a broad-based standard here does countervail the SEC's intent to restrict fund discretion, the Clinic believes the SEC strikes the correct balance in its proposal.

II. The Clinic Supports Proposed AFFE Rule Change with Modifications.

Within the framework of the Investment Company Act of 1940, the SEC has long strived to effect a balance between economic growth and investor transparency. To that end, the AFFE Rule was approved by the SEC in 2006 as an effort to create more transparency on the disclosure of fees charged to investors in funds of funds ("FOF") prospectuses. Prior to the 2006 AFFE Rule, investors in FOFs had poor visibility into the operating expenses incurred by the various underlying funds in the portfolio. Following the implementation of the AFFE Rule, investors have had enhanced visibility into overall fees and management expense ratios because an FOF prospectus must now include a separate AFFE line item in the fees and expenses table. This line item includes the fund's pro rata share of the all of the acquired fund's expenses which is then incorporated into the fund's overall expense ratio.

The implementation of the AFFE Rule presupposed there would be no adverse effect on capital formation. Unfortunately, there have been significant unintended consequences with respect to Business Development Companies ("BDCs"). Because BDCs have inherently higher asset-weighted fees than open-end funds, their expense ratios as disclosed under the AFFE Rule have made many of them ineligible for listing in the FTSE Russel and Standard and Poor's indices, resulted in less liquidity, a depressed market for BDC stocks, and an adverse effect on capital formation.

The proposed change to the AFFE Rule seeks to strike a balance between rectifying the unintended detrimental effect on BDCs and preserving investor transparency on fee loads. The SEC proposes that the AFFE disclosure would drop to a footnote rather than a line item in the fees and expenses table for those funds that have invested 10% or less of its assets in other funds. The status quo, where acquired funds and expenses are provided as a line item, would prevail for funds that invest greater than 10% of its assets in acquired funds. We support this rule change with the following comments.

Investors in inherently risky, development-stage companies and BDCs, require comprehensive and comprehensible disclosures. Provided that such disclosures are accurate and clear, it is desirable for BDCs to be allowed to flourish and for investors to have broad access to this asset class.

To satisfy the need for transparency, we believe the proposed modifications to the AFFE Rule must include more than lip-service to the 2008 SEC rule requiring that mutual fund prospectuses be written in plain English. Specifically, we recommend that for those funds exempted from including affiliated fees in the fees and expenses table, the footnote language provided in the table be clear and standardized.

Possible boilerplate language for the footnote might be:

Excludes fees associated with funds in which our aggregate investment is less than 10% of our total asset value. If we had included these fees, the expenses of our fund as stated in the above table would have been higher.

In addition, the footnote should provide the total amount of the fund's AFFE so that investors have complete transparency as to the magnitude of the expenses that have been excluded from the fee calculation.

The majority of retail investors base their investment decisions on the guidance of financial professionals or on direct exposure to fund advertising and sales brochures. Therefore, plain language disclosures with respect to fees for footnote-eligible funds must extend to advertisements. For these funds, we would like to see clear boilerplate language following the fee disclosures in advertisements. Possible language might be:

Less than 10% of our assets are in other funds in which we have acquired shares. In calculating our fees, we have excluded the fees associated with these funds. If we had included these fees, the expenses of our fund would have been higher.

III. The Clinic Supports Requirements to Promptly Notify Shareholders of Significant Changes, But Proposed Rule 498B Does Not Define When a Change Satisfies 'Material' Requirement.

The SEC projects the changes in the annual reports as part of a rearrangement of how fund data is provided. As part of the plan, certain shareholder information which may be more applicable for financial specialists than retail investors would no longer be included in a fund's shareholder report but instead be made available online or by request.[12] Additionally, the fund would not deliver annual prospectus updates to existing investors.[13] Instead, the fund's shareholders reports would be the source of updates. A condition of proposed Rule 498B is that the fund must have a summary prospectus.[14] To ensure that shareholders continue to be notified of key information, the proposed rule lists important events that require prompt notice to shareholders on material changes.[15]

Requiring funds to promptly notify shareholders of significant changes is a laudable goal, but the proposed rule does not specifically define when a change satisfies 'material' requirement to warrant a prompt mailing to current shareholders. Additionally, the proposed rule would present pressure on judgment around when a summary of a change in the annual report is sufficiently complete. Finally, given the different disclosure systems for existing shareholders and new investors, there could be a risk arising from the potential gap between two groups.

12 Release at 1.
13 Release at 2.
14 Release at 8.
15 Release at 108.

IV. The Clinic Supports Requirements to Disclose Principal Risks in Order of Importance, But Evaluating the Level of a Particular Risk in Relation to Other Risks Can Be a Difficult and Subjective Task, and Is Subject to Changes.

The amendment aims to modify prospectus by providing guidance that a principal risk would place more than 10% of the fund's assets at risk or is reasonably likely to meet this 10% standard in the future.[16] The amendments also propose fund-specific, tailored risk disclosure as well as ordering risks by importance.[17] The Clinic agrees that requiring funds to disclose principal risks in order of importance reduces the chance that important risks may be unnoticed.

However, this requirement would generate practical considerations as evaluating the level of a particular risk in relation to other risks can be difficult and subjective task. This task can often be subject to change due to circumstances not under the control of the fund firm such as market changes or regional risks. Furthermore, given that 10 percent assets at risk threshold has not been launched in the past, the anticipated effect of the modification would be that the risks currently regarded as principal risks will no longer be deemed principal which would require major adjustment.

The Clinic thus encourages the SEC to examine the likely effect of disclosure scope reduction in light of another proposed changes to minimize initial implementation costs and facilitate a smoother transition. The efforts to improve the shareholder experience through a closer scrutiny will better put new ideas forward if combined with careful consideration of interests and the needs of both fund firms and retail investors in a practical setting.

V. The Clinic Supports Reducing Existing Complexity Arising from Discussions of Multiple Shareholder Classes.

The proposal seeks to modify how funds' annual reports are presented by requiring a fund to prepare separate annual reports and regulating the scope of contents in the reports. The proposal points out that the fact that a single shareholder report may have to cover multiple shareholder classes—their varying sales load and distribution fee accounting for the differences—could possibly contribute to its lengthiness and complexity.[18] The proposal correctly notes that a report furnishing information regarding multiple series of investments for a number of share classes could increase the risk of shareholder confusion.[19]

The Clinic agrees that the aforementioned problems could be alleviated with a more focused report through which a shareholder receives tailored information pertaining to the series in which he or she has invested. The proposal lays out certain types of information permitted to be included in the report, and unlike before, the proposal seeks to remove certain items from the

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[16] Release at 142.
[17] Release at 120.
[18] Release at 52.
[19] Release at 52.

report such as "Changes in and disagreements with accountants," much of "Financial highlights," "Results of any shareholder votes during the period," and etc.[20]

There is, however, a need for some amount of flexibility as to the certain types of information a fund should be able to make a reference to in its annual reports.[21] Considering the unique circumstances possibly surrounding a particular fund and its investment, certain types of information disallowed by the proposal could prove to be relevant, and whatever permitted to be mentioned in the annual reports could be presented more coherently if accompanied by a quick reference to such supporting information. Also, there would be no need for a shareholder to go through the hassle of finding the information online.

VI. The Clinic Supports the Revisions of Performance-line Graph in Shareholder Reports.

The clinic shares the same concern with respect to the performance-line-graph requirement: because funds have discretion in choosing the indexes, they could deliberately select the ones outperformed by the fund in order to mislead the shareholders.[22] In addition, the proposal is correct in noting that sometimes even the most widely accredited indexes cannot be perfect means for comparison due to the possibility of regulatory, accounting, and auditing differences.[23]

This said, the clinic agrees with the three revisions the proposal mentions, but would also like to propose the SEC to choose a couple of market indexes that the funds must include in their shareholder reports—this way, the SEC could ameliorate the risk of funds abusing their discretion.

The clinic would also like to recommend that the SEC allow funds the discretion to denote, alongside the dollar-value change in a hypothetical $10,000 investment, percentage returns in their performance line graphs.[24] It is the Clinic's belief that this combination of both dollar and percentage values will allow shareholders a more convenient way to compare performance.

[20] Release at 50–51.
[21] Release at 57.
[22] Release at 95.
[23] Release at 96.
[24] Release at 93.

Conclusion

We respectfully request that the Commission take our comments in to consideration in addressing the proposed rules.

Respectfully Submitted,

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