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December 29, 2020

VIA E-MAIL

Office of the Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549
Attn: Ms. Vanessa Countryman, Secretary

Re: Proposed Rule: 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

Ladies and Gentlemen:

We appreciate the opportunity to comment on the Securities and Exchange Commission proposals set forth in this release.[1] While we support the Commission's initiative to modernize how funds communicate with their shareholders, we have comments and concerns with certain aspects of the proposals, which we discuss below.

The comments in this letter reflect the views of a group of lawyers in our firm who regularly advise funds and investment advisers. While we have discussed certain matters in the proposing release with some clients and colleagues, we are not making these comments on behalf of any client, nor do our comments necessarily represent the views of our clients or colleagues.

PROPOSED AMENDMENTS TO ANNUAL AND SEMI-ANNUAL SHAREHOLDER REPORT DISCLOSURE

We agree with the Commission's assessment that a more tailored, graphic reporting format would be useful and appreciated by most shareholders. If such an approach is adopted, however, we encourage the Commission to reconsider certain aspects of the proposed amendments, especially the heavy emphasis on brevity and restrictions on discretionary content.

1. An Emphasis on Brevity and Consistency Should Not Unduly Limit Disclosure

As proposed, a fund would provide to its shareholders in an annual or semi-annual report only that information that proposed Item 27A of Form N-1A would specifically permit or require – subject to a limited exception allowing for additional information if necessary to make the report not misleading. This proposal appears to us to establish an unnecessarily narrow standard.

The Commission's goal in proposing these rules, as we understand it, is to design approachable, user-friendly disclosures that both educate and protect shareholders. To achieve this goal, registrants would

[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," Investment Company Act Release No. 33963 (Aug. 5, 2020) (the "Proposing Release").

have to exercise sound judgment, which therefore would require them to exercise a degree of discretion. We appreciate that the Commission is not proposing specific word or page limits, but we believe any flat restrictions on disclosure will not be able to account for the variety of different funds and variety of market conditions and events that may arise. We do endorse specifying a standardized order in which to present core information, which facilitates comparison of information across funds and fund complexes.

To provide somewhat more flexibility, we respectfully encourage the Commission to consider permitting registrants to include in these reports supplemental information reasonably related to the required content. The Commission already proposes to allow supplemental statistical information relevant to a fund's holdings, but we respectfully suggest that a broader exception will better support thoughtful, balanced disclosure. For the same reason, and as the release suggests might be considered (in its request for comment #5), we support "permitting space for funds to disclose other information they deem important for fund investors" – what we presume would be an unrestricted section of the report available for discretionary content.

2. **The Commission Could More Clearly Address Liability Concerns**

We expect some market participants will have questions whether streamlined reports could give rise to added liability by significantly narrowing the totality and range of disclosure that fund shareholders and prospective investors would receive in their reports. Full fund financial statements still would be filed with the Commission and can be incorporated by reference into a fund's registration statement (and would be posted to firm websites), which significantly addresses these concerns. We believe, however, that the Commission could do more to respond to liability concerns in any final release.

For example, in the 2009 release adopting the summary prospectus[2], the Commission said the following:

> The Commission believes that a person that provides investors with a mutual fund Summary Prospectus in good faith compliance with rule 498 will be able to rely on Section 19(a) of 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. Section 19(a) protects a defendant from liability for actions taken in good faith in conformity with any rule of the Commission.

We believe that similar language in any final release adopting a streamlined shareholder report would be appropriate and would provide additional assurances for those concerned about their liabilities when proceeding under the new framework.

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[2] "Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies," Investment Company Act Release No. 28584 (Jan. 13, 2009).

3. <u>The Proposal May Give More Emphasis to Liquidity Disclosure Than Is Needed for Many Funds</u>

The proposed shareholder report would include a discussion on liquidity risk, as well as how this risk is managed. Sample discussion is provided within the Hypothetical Streamlined Shareholder Report (the "Hypothetical") and occupies just under half of the last page in a three-page document. We observe that, when considered in the context of a short document, even a paragraph or two can result in an elevated profile for the topic. There is also the reality that allocation of space will be at a premium for such a document, and that inclusion of any discussion therefore warrants careful consideration.

With that background, we refer to the questions the Commission asks in the proposal regarding liquidity risk and especially whether all funds should be required to include the proposed liquidity risk disclosure (see request for comment #105). We respectfully suggest that the Commission might consider an exemption for funds for which the disclosure will be less relevant. This could include funds whose assets are primarily highly liquid or "in kind" redemption exchange-traded funds, each as contemplated by the liquidity rule

4. <u>The Commission Might Speak To Future Risks of "Comment Creep"</u>

Elements of the Hypothetical illustrate how "comment creep" might change – and eventually overwhelm the best intentions for – simple, streamlined presentations. For example, the Hypothetical uses phrases like "duration" and "maturity" without explanation. Presumably the view in doing so is that the overall context gives meaning and that this report is one just part of a layered disclosure set, which can include detailed explanations of terms and risks elsewhere.

Should Commission disclosure review or examination staff take a different view, however, we could see pressure over time for registrants to provide more and more explanations and risk commentary around "technical" phrases of this nature (indeed, the proposed Item 27A instructions direct that registrants avoid "jargon" or "highly technical terms," providing a ready basis for comments of this nature). The result is what is sometimes referred to as "comment creep" – well-meaning pressure for explanation that could frustrate the Commission's stated goals for a crisp, highly visual presentation. We respectfully submit that any final release based on a streamlined shareholder report should be an opportunity for the Commission to both speak to this sort of risk and clearly articulate that layered disclosure is premised on the idea that explanation and understanding derives from the whole of the layered disclosure set and certainly not from individual phrases or sentences in isolation.

PROPOSED RULE 498B RELATED TO SHAREHOLDERS' CONTINUED RECEIPT OF ANNUAL PROSPECTUS UPDATES

We understand that it is customary at present (a) for current fund shareholders to receive copies of the prospectus at each annual update and (b) for funds to make judgments as to whether any intra-year supplement to the prospectus warrants mailing to current shareholders or instead will be made on a "fulfillment-only" basis (in which it is included in all new prospectus delivery packages but is not separately mailed to current shareholders). We also understand proposed Rule 498B could significantly change these practices.

Rather than require funds to provide disclosure of material changes to current shareholders via ongoing prospectus updates, the proposed rule would permit funds that so elect to provide summaries of material changes – before those changes take effect – via the fund's annual report. When a change is not or cannot be included in the annual report before taking effect, the proposed rule contemplates that it be made through a prospectus amendment or supplement and that "notice" of the change be mailed to shareholders within three business days.

We defer to other stakeholders on the policy merits and operational considerations of Rule 498B's proposed framework. We do, however, have a number of practical concerns, discussed below.

1. The Commission Could More Clearly Address Liability Concerns

We believe there is some confusion as to how the different disclosure documents will work together. As a primary example, the listing of material changes contemplated for the annual report might appear to be a kind of stand-in or quasi-prospectus and – from that – could lead to concerns as to whether all or part of the annual report might be subject to prospectus liability.

To be clear, that is not our understanding. Rather, it appears to us that the Commission's Rule 498B construct represents a form of "notice and access" for prospectus delivery, premised on the view that current shareholders are deemed to have read and received the ongoing prospectus updates. The fact that prospectus updates are available online and on request and that current shareholders will receive timely notices of changes to the prospectus – including through the annual report – appear to be the building blocks for that premise. But this is not clearly articulated in the proposing release.

Without a direct and plain explication of this point, we believe market participants will have questions about the liabilities to which funds would be exposed in opting into Rule 498B. These questions – which in our view have the potential to delay or limit voluntary adoption of the new framework – apply to both the summaries of material prospectus changes contemplated for the annual report and the intra-year "notices" of material change. We therefore respectfully encourage the Commission to provide additional clarity of its intent and meaning here. As we have suggested above, we believe it also would be appropriate if such additional clarity included references to the protections available to issuers under Section 19(a) of the Securities Act.

2. "Summarizing Changes" Can Be Complex

We start with the simple observation that implementing a summarization requirement is not straightforward. For example, consider a fund that makes enhancements to its real estate investment risk disclosure to discuss the impact of Covid-19 and related occupancy trends, rent and eviction forbearance rules and similar matters. The changes made likely will be knit into existing text, with new words, phrases or sentences added here and there, some text removed and some text reordered.

How would that be summarized?

- One might simply say: "We enhanced discussion of our real estate investment risks to highlight risks presented by pandemics." Is that sufficient or too brief?
- Or one might simply restate the real estate investment risk description in full. But is that a summary?

In other words, we foresee a series of complex analyses regarding how detailed the disclosure should be and in what format the disclosure should be presented. There will be competing goals of brevity and full disclosure, and it could be difficult to balance these considerations while still producing user-friendly and approachable content.

Those charged with making these judgments would, we expect, appreciate commentary from the Commission that summarization techniques can differ, that individual funds will be best placed to reach their own judgments on those techniques, and that those judgments should be given the benefit of doubt. This guidance should, in our view, specifically include a statement that determinations to restate sections of the prospectus in full can be appropriate and that the requirement to provide a "summary" not be taken as a literal instruction that every new concept necessarily requires special treatment and distillation outside the prospectus.

3. <u>Rule 498B May Result in Funds Sending More Frequent Notices of Prospectus Changes to Shareholders</u>

As we say above, we understand that funds treat prospectus supplements in different ways. In some cases, a prospectus supplement is mailed to current shareholders. In others, it is handled on a"fulfillment-only" basis (included in all new prospectus delivery packages, and available thereafter on request, but not separately mailed to current shareholders). This practice reflects the fact that funds might make changes to the prospectus that are not considered to be necessarily material (or perhaps might be considered more relevant to new shareholders).

An example was the widespread supplementing of prospectuses to refer to the Covid-19 pandemic and related risks. In initially assessing Covid-19, we understand that nearly all fund firms considered their existing market risk disclosure – i.e., that markets can be volatile and impacted by disparate social and governmental developments – to be sufficient. Many nonetheless determined that adding a more detailed discussion of the implications of Covid-19 would be desirable. On those facts, some funds elected to mail the prospectus supplement to current shareholders. Many others, however, reasonably judged the new disclosure to be beneficial but not material given existing disclosures and, accordingly, that the significant expense (and the intrusion) of such a mailing would outweigh the value.

Presumably Rule 498B is not intended to change these practices. However, we expect the structure of Rule 498B, and its emphasis on mailings to current shareholders within a specified time period (and the fact that such mailings are a predicate to the protections of the rule), could result in more frequent notices being sent to shareholders. Why, some will ask, take the risk, when a misstep might apply not just to whether a particular mailing is material but also to whether a fund can claim reliance on the rule as a whole. Once that view takes hold, it could color special mailing judgments across the industry, whether or not the funds involved are relying on the rule, and whether or not the disclosure changes are material to shareholders.

We respectfully suggest these possibilities should be considered by the Commission in evaluating how the rule would streamline (or not) the frequency of shareholder mailings. We also respectfully suggest these possibilities could inform the rulemaking's cost/benefit analysis, which then would consider both cost savings associated with not mailing the annual prospectus updates and additional costs that might be associated with more frequent intra-year mailings of notices of changes.

UPDATES TO RISK DISCLOSURE FRAMEWORK

While we support the Commission's goal of improving the risk disclosure framework, our experience preparing risk disclosure for a broad group of clients leaves us with important concerns regarding the proposed changes.

1. Ordering Risk Factors by Importance Requires Subjectivity and Would Be Complex

The Commission proposes that registrants should present risk factors in their order of relative importance. While this is an intuitively attractive proposition, it is far from straightforward.

Funds currently use a variety of approaches when determining how to present risk factor information, and these approaches vary among registrants. In our view, this flexibility has benefits whereby funds can present information in the manner that they believe is most useful for shareholders. While requiring a fund to order its risk factors in order of importance theoretically will have the desired effect of highlighting more significant risks, there are also important countervailing considerations, notably the level of subjectivity involved.

The nature of risk is that it is inherently uncertain. Identifying risks for inclusion in the prospectus requires judgment and selectivity, and the evaluation of those disclosure choices is often made with the benefit of hindsight. To make judgments about which of several risks are more or less significant necessarily requires a fund to make predictions about what risks may arise during a given year and to be prepared to reassess year after year and, for good or ill, to be prepared to be "wrong" with some frequency. Additionally, portfolio changes or market forces may make certain investments riskier during the course of a given year, which further complicates this analysis.

In this regard, we applaud the Commission for its proposed guidance that funds might use "any reasonable means of determining the significance of risks," but we also have to conclude this is likely to mean that different fund managers will weight different considerations differently. Thus, there will not just be the reality that different subjective views on risks (again, predictions) will drive different risk rankings, but different internal methodologies will as well. The net effect will be both that risks will be reshuffling year to year within a fund's prospectus and that different firms will be doing that reshuffling in potentially very different ways.

In other words, while well-intentioned and theoretically valuable, the outcome of a risk ranking requirement appears to us to be a recipe for confusion for all involved. We therefore respectfully suggest that the Commission reconsider this proposed requirement and take into account the benefit to shareholders of funds using a more flexible, holistic approach.

2. **<u>Requiring That Only Principal Risks Be Included, and Using a Set 10% Threshold, May Result in Less and Lower Quality Risk Disclosure</u>**

It is self-evident that limiting the risk factors that a fund may disclose to only those that are considered to be principal risks of the fund (as the Commission has proposed) carries risk that some otherwise useful risk disclosure will be lost. We understand the Commission's concern that overly broad disclosures may be irrelevant or less relevant but question whether a prohibition on voluntary risk disclosure is the best means of addressing that concern. We believe a better approach could be to encourage further diligence and care around such voluntary disclosure. This result might be achieved by requiring or encouraging a record of the determinations underlying the decision to include a non-principal risk.

We also wish to comment on the new proposed instruction to set forth a specific test to be used when determining whether a risk is a principal risk, and in particular that a fund should consider "both whether the risk would place more than 10% of the fund's assets at risk ("10% standard") and whether it is reasonably likely that a risk will meet this 10% standard in the future." We believe such a numeric benchmark can be useful as guidance but not as a fixed line dividing disclosures that would be made versus those that would not be made. As noted earlier, it may be impossible to determine whether a particular risk would put more than 10% of a fund's assets at risk. Further, this determination has an added layer of amorphousness given that funds also must consider whether a risk would be "reasonably likely" to reach the 10% standard.

We also observe that there is some variation in market practice today. We believe some firms look to a standard similar to that proposed; others look to a 5% threshold. This variation in approach may favor the adoption of specific guidance intended to shape greater uniformity of view. But it also follows that a 10% standard, if adopted and applied strictly, would result in funds withdrawing existing risk discussion that had been predicated on the lower 5% threshold. We do not believe funds should be forced to strip out risk disclosures and should instead be given time and flexibility to assess any new guidance. Here again, some firms may appreciate the flexibility we suggest above to determine whether to include non-principal risk disclosure.

3. **<u>Tailored Risk Disclosure May Be Impractical to Implement and Contrary to Other Important Goals</u>**

The Commission proposes that risk discussion be tailored to individual funds, with the general concept being that the same discussion of the same risk in two different funds may not be appropriate and may not capture how that risk might differently affect the two funds. As with the proposal to require risk-ranked presentations, this is both an intuitively attractive proposition and far from straightforward.

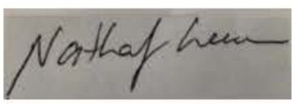
Just as with risk-ranked presentations, we believe tailoring the description of risks on a fund-by-fund basis is prone to considerable subjectivity. Assessing how different two funds must be to warrant different treatment of their risks will, again, be an exercise in prediction. It is also possible that the outcome will be more confusing than useful to the reader parsing potentially subtle differences in language. Finally, it is our experience that many funds use carefully developed and maintained "risk libraries" in order to be consistent and complete in their disclosure. This is an important internal governance process that could be frustrated by zealous application of the proposed approach. For each of these reasons, we respectfully suggest that the Commission reconsider the proposed requirement.

* * *

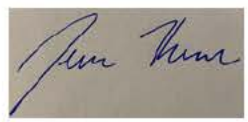
We sincerely appreciate the opportunity to submit our comments. We hope that we have provided useful context.

If you would like to discuss any of our comments, please do not hesitate to contact Nathan J. Greene at [redacted] or Jesse C. Kean at [redacted].

Respectfully submitted,



Nathan J. Greene



Jesse C. Kean