January 4, 2021

Ms. Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: SEC File No. S7-09-20; Release Nos. 33-10814; 34-89478; IC-33963: Comments 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

Dear Secretary Countryman:

Franklin Square Holdings, L.P., d/b/a FS Investments ("FS") appreciates the opportunity to comment on the Securities and Exchange Commission's (the "Commission" or the "SEC") Release Nos. 33-10814; 34-89478; IC-33963 (the "Proposing Release") in which the Commission proposed to adopt new Rule 498B (the "Proposed Rule") under the Securities Act of 1933, as amended, and other corresponding proposed rule amendments and related changes to Forms N-1A and N-CSR. FS supports the Commission in its intended goal of making reports more easily accessible and useful for retail investors, and commends the Commission for seeking feedback on its proposal to modernize the disclosure framework for mutual funds and exchange-traded funds ("ETFs").

FS, founded in 2007 in Philadelphia, Pennsylvania, manages alternative investment funds -- including business development companies ("BDCs"), real estate investment trusts, mutual funds and closed-end funds -- and is dedicated to helping individuals, financial professionals and institutions design better portfolios and access alternative sources of income and growth. While we strongly support the Commission's initiatives to make fund reporting more concise and useful for retail investors, including certain of the initiatives set forth in the Proposing Release, we have recommendations for enhancing the Proposed Rule consistent with the Commission's goals of modernizing the reporting framework and protecting fund investors.

Content and Manner of Delivering Disclosure

FS strongly supports the use of a streamlined shareholder report to provide investors with the information that is most relevant in a more concise and user-friendly format. In fact, the proposed layout and content included in the sample shareholder report are consistent with the fact sheets that many mutual funds already provide to investors. While streamlining the content of the shareholder report is a step in the right direction, we believe that using electronic media as a primary means of disseminating all fund information, including shareholder reports, is necessary to fully effectuate a central goal of the Proposing Release: ensuring that investors receive the relevant information about the fund in a format that is digestible and that honors the preferences of each investor. In the Proposing Release, the Commission recognized the internet's "important role in providing disclosure materials and other information to investors

and maximizing investor access to information."[1] With nearly 95% of mutual fund investors having access to the internet[2] and over 80% of adults owning a smartphone,[3] electronic media has become the predominant way in which most retail investors consume information. While we recognize that technology-driven initiatives can often have a disparate impact on certain groups, we do not believe our recommendations would negatively impact those affected by the digital divide. In fact, we believe a move toward e-delivery as a default would increase access overall.[4] The Commission's proposal, while advancing its goal to create a layered framework for fund materials, unfortunately falls short of creating an effective mechanism for investors to receive such materials.

FS recommends that the SEC permit funds to e-deliver disclosure documents to all new and existing shareholder accounts with advance notice to shareholders of the upcoming change to e-delivery. Over the past several years, FS has experienced a significant shift toward the use of electronic media by advisors and investors, a trend which has been amplified during the ongoing COVID-19 pandemic. This past year, we have utilized electronic delivery for nearly all our communications with prospective and existing investors in our closed-end and open-end funds, with very few requests for printed materials. We expect this trend to continue in the future. In recognition of this reality, electronic delivery should become the default for delivery of *all* fund information, including annual and semi-annual shareholder reports, prospectuses and other reports. Any shareholder that prefers to receive printed documents would have the ability to "opt in" to paper delivery as they do today for electronic delivery. This approach would allow investors to receive fund information in a digestible format, honor their clear preference for e-delivery and achieve significant cost efficiencies. Retaining paper delivery as the default does little to modernize the way in which funds make information available to investors and instead perpetuates a regime where the desires of a small minority increase the costs borne by all fund shareholders.

FS recommends that the Commission retain Rule 30e-3. Rule 30e-3 under the 1940 Act will allow all registered investment companies to make shareholder reports available online as early as January 1, 2021, by providing a notice of their availability, instead of transmitting the reports directly to shareholders, unless requested. The Proposed Rule would narrow the scope of Rule 30e-3 to exclude mutual funds and ETFs registered on Form N-1A, so that they would be required to continue to deliver these reports to shareholders by mail or if the shareholder requests, electronically. The exclusion of mutual funds and ETFs from Rule 30e-3 frustrates the purpose of the Proposed Rule and goes against overwhelming evidence of the use of electronic media and the need to expand, not reduce, the use of e-delivery.

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[1] Proposing Release at 33.

[2] Id.

[3] Pew Research Center, Internet & Technology Report (June 12, 2019). Available at https://www.pewresearch.org/internet/fact-sheet/mobile/ (the "Pew Research Center Report").

[4] According to the Pew Research Center Report, as of 2019, the percentage of adults who use the internet by race/ethnicity was as follows: White: 92%; Hispanic: 86%; African American: 85%. The percentage of adults who use the internet by income level was as follows: Over $75,000: 98%; $50,000-$74,999: 97%; $30,000-$49,999: 93%; Less than $30,000: 82%. The percentage of adults who use the internet by education level was as follows: College graduate: 98%; Some college: 95%; High school graduate: 84%; Less than high school graduate: 71%. The percentage of adults who use the internet by community type was as follows: Suburban: 94%; Urban: 91%; Rural: 85%.

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Disclosure of Fees and Expenses

We support the Commission's goal of streamlining the disclosure of fees and expenses and offer the following recommendations intended to ensure that the presentations (i) are consistent across various disclosure documents, (ii) avoid investor confusion resulting from different presentations of fees and expenses within the same document, and (iii) more accurately distinguish between direct expenses and the range of indirect expenses that impact the performance of the fund.

Fee Table Presentation

The Proposing Release would replace the existing fee table in the summary section of the prospectus with a simplified "fee summary," with the existing fee table being moved to the back of the statutory prospectus. We recommend that the Commission retain the existing fee table, as the proposed fee summary provides substantively the same information in a different format that could result in confusion for shareholders. Requiring funds to present the same information in two different formats is not consistent with the "layered" approach the Commission is intending to implement through the Proposing Release. Rather, the Commission should consider adopting a single presentation of fees and expenses for prospectuses, shareholder reports and other disclosure materials produced by registered investment companies.

Acquired Fund Fees and Expenses

We commend the Commission for focusing on the disclosure of acquired fund fees and expenses ("AFFE") and attempting to address the unintended consequences that the existing AFFE framework has had on BDCs in particular. As recognized in the Proposing Release, the existing AFFE rules have resulted in BDCs being dropped from indices such as the S&P 500 Index and the Russell 2000 Index and a reduction in institutional ownership.[5] The Proposed Rule will allow a fund that invests 10% or less of its total assets in underlying funds ("Acquired Funds") to disclose AFFE in a footnote rather than as a separate line item in the fee table. A fund that invests more than 10% of its total assets in Acquired Funds still would be required to include the AFFE line item in its fee table. While the Proposed Rule touches upon some of the historic concerns with the existing AFFE framework, we believe that it does not go far enough. For the reasons outlined below, we recommend that the staff eliminate the 10% threshold for disclosure in the fee table and require all AFFE to be disclosed in a footnote to the fee table.

The purpose of the prospectus fee table is to disclose the actual cost of investing in a fund. These costs are comprised of (i) the expenses incurred in connection with particular investor transactions, such as purchases, exchanges and redemptions, and (ii) regular fund operating costs not associated with a particular investor transaction, such as investment advisory fees, marketing and distribution expenses, custodial, transfer agency, legal and accounting fees.[6] In

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[5] See Wells Fargo Securities Equity Research, The 2Q18 BDC Scorecard (Jan. 18, 2017). See also Raymond James, BDC Ownership Percentage by Investor Type (April 2019). The market cap weighted average of BDC ownership by institutional investors plunged by approximately one-quarter year-over-year between the end of Q4 2013 (42.2%) and Q4 2014 (31.7%). This percentage decline increased to approximately 35 percent through Q4 2018 (27.6%). (unpublished report with data sourced from FactSet; institutional holdings for December 31, 2018, and December 31, 2015, excluding holdings from private banks/wealth management firms, brokers and investment banks; and insider holdings).

[6] SEC Form N-1A, Item 3.

total, these expenses reflect the direct costs incurred by a shareholder in a fund.

The fee table does not reflect the indirect costs that a fund incurs in pursuing its investment objective, such as brokerage commissions and other transaction costs, the implicit financing costs of derivatives, securities lending expenses, the expenses of certain pooled vehicles and other expenses associated with a fund's investments. These costs are reflected in the financial returns of the particular investment and, as a result, the performance of the fund holding that investment.

For funds that invest in other funds, the AFFE requirement provides for an additional line item in a fund's prospectus fee table that discloses the pro rata share of the expenses of a fund that it has acquired. The AFFE requirement was originally adopted by the SEC to "provide investors with a better understanding of the actual costs of investing in a fund that invests in other funds."[7] For such funds, AFFE is added to a fund's operating expenses and reflected in the total expense ratio on the fund's fee table. While the AFFE requirement was intended to provide a better understanding of the costs of investing in a fund of funds, we believe that it creates misleading, confusing and inconsistent fee table disclosure.

AFFE are not "expenses" under generally accepted accounting principles. As a result, AFFE are not reflected in a fund's expense ratio in the financial statements and shareholder report.[8] For a fund that invests in other funds, the AFFE requirement to include acquired fund expenses in the prospectus fee table causes a fund to provide inconsistent representations of its expense ratio across its regulatorily required documents. This inconsistency could be addressed by eliminating the AFFE requirement to reflect acquired fund expenses in the prospectus fee table.

AFFE are not direct expenses of the acquiring fund; rather they represent the indirect expenses of a particular investment. For that reason, they are not an appropriate addition to the prospectus fee table, which is intended to capture a fund's direct shareholder and operating expenses. Investment and other indirect expenses incurred in pursuing a fund's investment objective are not included the prospectus fee table because they are reflected in fund returns. Subtracting an acquired fund's expenses from an acquiring fund's performance returns while adding them to the acquiring fund's fee table "double counts" those expenses and overstates the true cost of investing in the acquiring fund. Other indirect investment expenses are not captured in the prospectus fee table notwithstanding the fact that they may far exceed the costs of investing in an underlying fund.[9] In her statement on the tailored shareholder report proposal, Commissioner Peirce explored some of the challenges attendant to the disclosure of AFFE.[10] Her comments focused, in part, on the distinction between direct expenses charged to a fund and the indirect expenses "incurred in the process of producing returns." Commissioner Peirce asks whether it would "make more sense for all AFFE disclosure to be in the footnotes?" We believe that it does. Mixing direct and only select indirect investment expenses in the fee table is confusing and misstates a fund's expense ratio. This inconsistency could be addressed by eliminating AFFE from the prospectus fee table.

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[7] *Fund of Funds Investments*, SEC Release Nos. 33-8713; IC-27399 (June 20, 2006) (the "Fund of Funds Release").

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

[9] For example, a fund that solely utilizes total return swaps to obtain exposure to the S&P 500 would appear to be much less costly than a comparable fund that uses S&P 500 ETFs because of the disparate treatment between a fund's underlying transactional expenses and its AFFE.

[10] Commissioner Hester M. Peirce, Statement on Tailored Shareholder Reports (August 5, 2020).

While we believe that the disclosure of AFFE in a fund's prospectus fee table is confusing and inconsistent with the treatment of other indirect investment expenses, we believe that disclosing AFFE in a footnote to the prospectus fee table would serve the SEC's original intent behind the AFFE requirement. In adopting the AFFE requirement, the Commission explained that it was intended to "provide investors with a better understanding of the actual costs of investing in a fund that invests in other funds." [11] The actual cost of investing in a fund is the sum of the direct cost of investor transactions in a fund and direct fund operating expenses. Including a subset of the indirect costs associated with the fund's investment portfolio in the fee table does not provide a better understanding of the actual costs of investing in a fund because it is incomplete. Including some, but not all, indirect expenses in the prospectus fee table is confusing and inconsistent with the objectives of the fee table. For these reasons, we believe that the original purposes of the AFFE requirement and investor understanding would be better served by including AFFE in a footnote to the prospectus fee table.

Modernizing the Disclosure Framework for Closed-End Interval Funds

In the Proposing Release, the Commission asks whether certain of the proposed changes should be made applicable to closed-end funds.[12] While we understand the need for certain differences between the disclosure framework for mutual funds and traditional closed-end funds, we believe that the Commission should consider modernizing the framework for closed-end funds consistent with our recommendations for mutual funds and ETFs. Specifically, FS recommends that the SEC (1) permit closed-end funds to e-deliver disclosure documents to all new and existing shareholder accounts with advance notice to shareholders of the upcoming change to e-delivery and (2) make amendments to Form N-2 and corresponding rules regarding closed-end fund fee disclosure to require all AFFE to be disclosed in a footnote to the fee table for closed-end funds. Further, the Commission should consider modernizing the notice and delivery requirements for interval funds, which serve an important role between liquid mutual funds and illiquid closed-end funds and have become a growing portion of the closed-end fund market.

When Rule 23c-3 was adopted, the Commission recognized that a considerable gulf existed between open-end funds and closed-end tender offer funds.[13] In an effort to "chart new territory" between the two extremes of the open-end and closed-end forms,[14] the Commission adopted Rule 23c-3, which provides a framework for closed-end funds to provide periodic liquidity without complying with the tender offer rules promulgated under the Securities Act of 1934.[15] Rule 23c-3 was an important step in making it possible for retail investors to access vehicles that offered portfolios with exposure to illiquid assets with greater liquidity than traditional closed-end funds.

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11 *See* Fund of Funds Release at 20.

12 Proposing Release at 63.

13 Periodic Repurchases by Closed-End Management Investment Companies, Rel. No. IC-18869 (July 28, 1992) ("Rule 23c-3 Proposing Release").

14 See *Protecting Investors: A Half Century of Investment Company Regulation, Report of the Division of Investment Management*, Securities and Exchange Commission (May 1992) at 421 ("Protecting Investors"), a report in which the Commission first introduced the concept of interval funds after a two-year study of the investment management industry.

15 Repurchase Offers by Closed-End Management Investment Companies, Rel. No. IC-19399 (Apr. 7, 1993) ("Rule 23c-3 Adopting Release").

Although the Commission adopted Rule 23c-3 in 1993, interval funds were not immediately adopted by issuers and not an area of focus for regulators. The second interval fund was not created until 2001 and the third was not created until 2005.[16] For nearly three decades, interval funds suffered from a lack of demand, a lack of familiarity by market participants with the requirements of Rule 23c-3, and a lack of familiarity by investors. Recently, however, there has been a substantial uptick in interval fund registrations and notable asset growth indicating increased interest from managers, distribution partners, and investors. Since 2014, interval funds have grown at an annual rate of 36.0% as of March 2020 with $33.1 billion in assets. During this same period, tender-offer funds increased to $29.2 billion. In 2014, interval funds represented only 19.0% of the unlisted closed-end fund marketplace, increasing to 53.1% as of March 31, 2020.[17] As of September 30, 2020, there were a total of 72 interval funds in offering with a combined $35.6 billion in AUM.[18]

The recent proliferation of interval funds has also served to further the Commission's goal of providing retail investors with increased access to private assets. Their widespread adoption is being hampered, however, by a reporting and operating regime that makes them less efficient and more expensive than mutual funds. We believe the time is right for the Commission to take additional steps to modernize the framework for how retail investors interface with interval funds, which would lower costs and increase operational efficiencies. Rule 30e-3 was a step in the right direction, and we expect widespread adoption by interval fund sponsors, including FS, beginning in 2021. Aligning closed-end fund reporting more closely with that of mutual funds, including the use of summary prospectuses and the integrated, layered disclosure regime described above would further this initiative. We also believe that there are additional steps the Commission could take to make interval funds more accessible to retail investors while maintaining investor protections.

One of the distinguishing features of interval funds is their periodic repurchase offers. Rule 23c-3 provides a formulaic and prescriptive set of conditions that issuers must follow to rely on the rule.[19] Rule 23c-3(b)(4) requires that notification of each repurchase offer be sent to common shareholders no less than 21 days and no more than 42 days before the repurchase request deadline. The repurchase notices are lengthy, often repetitive documents, that require substantial time and effort to produce and mail, the costs of which are borne by fund shareholders. In adopting this provision of Rule 23c-3, the Commission observed that indirect notification of shareholders may be adequate for issuer tender offers due to the "tight schedules" under which such offers are conducted, while noting that Rule 23c-3 quarterly repurchase offers presented "no comparable time pressure." In practice, Rule 23c-3 has resulted in costly printing and dissemination of notices on a quarterly (or more frequent) basis for repurchase offers that often have identical terms.

We believe that it would be more effective to provide notice to shareholders through a different medium – the fund's registration statement, website or other means of electronic delivery – given the high costs and inefficiencies of conducting a repurchase offer for each interval. In this scenario, funds would be required to include all of the substantive information required by Rule

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16 Closed-End Fund Advisors, *Quarterly Closed-End Fund & BDC Review and Outlook*, October 8, 2020 ("CEF Advisor Outlook").

17 FUSE Research Network, September 2020.

18 CEF Advisor Outlook.

19 SEC Rule 23c-3: Repurchase offers by closed-end companies (17 CFR § 270.23c-3).

23c-3(b)(4) in the fund's registration statement and website, and would commit to provide repurchase documents to shareholders upon request. In addition, the repurchase interval and timing would be a fundamental feature of the fund. The fund's registration statement could provide a clear explanation of the fund's periodic repurchase program, which would become as routine in the shareholder's mind as daily redemptions are in the mind of open-end fund shareholders. The fund would be required to provide shareholders with notice of any material changes to the repurchase offers, including with respect to a decrease in the amount to be repurchased or the timing of repurchase intervals.

FS Investments sincerely appreciates the opportunity to submit our comments on the Proposal. We hope we have provided useful feedback with our recommendations, and we welcome the opportunity to continue to discuss these important issues with the Commission.

If you have any questions or would like to discuss our views further, please contact Marc Bryant at [redacted] or [redacted].

Respectfully submitted,

Marc Bryant
Chief Legal Officer
FS Investments

Michael F. Gerber
Chief Corporate Affairs Officer
FS Investments

cc: The Honorable Elad L. Roisman, Acting Chairman
The Honorable Hester M. Peirce
The Honorable Allison Herren Lee
The Honorable Caroline A. Crenshaw
Dalia Blass, Director, Division of Investment Management