IDC Independent Directors Council
Promoting Excellence in Fund Governance

ICI Recommends Ways SEC Can Further Modernize Fund Disclosure and Improve the Investor Experience

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Reforms Needed to Reflect Shareholders' Preferences, Better Enable Use of Technology, and Promote Tailored Risk Disclosure

Washington, DC; December 22, 2020—A modern fund disclosure system should provide investors with digestible, layered information, delivered according to their preferences, the Investment Company Institute said in a comment letter filed with the Securities and Exchange Commission (SEC). The letter further states that the SEC's proposed framework to modernize fund disclosure meets some, but not all, of these goals, and modifications are needed to better satisfy investor preferences and reduce costs for investors.

Regulated funds send their shareholders documents, including shareholder reports and prospectuses, to help them understand a fund's objective, investments, fees, risks, performance, and more. Investors receive these documents via postal mail, unless they explicitly tell a fund to email them, also known as e-delivery. Printing and mailing paper documents is expensive, and all investors bear these costs.

"ICI fully supports Chairman Clayton's statement that the time has come for the SEC to modernize the framework that governs how funds may deliver information to investors," said ICI President and CEO Eric J. Pan. "To this end, the SEC should take into account investors' preferences and make it easier for funds to e-deliver information to them. Our comments on the SEC proposal seek to better align fund communications with what investors prefer, while also reducing their costs."

ICI provides input on three specific aspects of the SEC's proposal:

Retain Rule 30e-3 to Satisfy Investors' Preferences

On January 1, 2021, under a newly effective regulation—Rule 30e-3—many of ICI's members will begin mailing investors a notice explaining that shareholder reports are available on their websites. Though funds must continue to send a paper copy of the full shareholder report to investors who request it, an ICI survey of member fund companies shows that less than 0.5 percent of shareholders who have accounts through funds have opted for paper shareholder reports in response to fund statements informing them that they may do so.

One part of the SEC's proposal would amend Rule 30e-3 so that neither mutual funds nor exchange-traded funds (ETFs) would be able to deliver 30e-3 notices to shareholders in place of the full shareholder report. Given that receiving a notice clearly satisfies most shareholders' preferences, as illustrated by the survey results, ICI disagrees with this part of the proposal, calling on the Commission to retain Rule 30e-3 and to let shareholders choose whether to receive the notice or the full report (pages 11–13). Funds have spent a considerable amount of time and money educating investors about how to access shareholder reports online and preparing to deliver the notices. Even more importantly, ICI contends, this process has created an expectation among investors about how they will receive information in the future.

Streamlined Shareholder Report Helps Investors, but Needs Modifications

The shorter length and streamlined style of the SEC's proposed shareholder report would make it easier for investors to understand key information and is similar to a prototype that ICI created and tested with investors. Specifically, ICI's testing indicated that investors would be more likely to read a shorter shareholder report and that such a report can successfully communicate content.

The Commission, however, would require funds to briefly describe any material change that happened during a particular period of time, and proposes a detailed list of material changes that funds must address. ICI disagrees with this approach. Different funds have different investment objectives, holdings, strategies, and risk profiles. ICI's letter recommends that the fund determine which changes to include in the report and to include them in a prominent and consistent location (pages 28–31).

SEC Should Retain Principles-Based Approach Toward Risk Disclosure

A fund is required to summarize in its prospectus the principal risks of investing in that fund. Under the current approach, funds decide what constitutes principal risks based on, among other things, their investment objectives and strategies. The SEC's proposal would require a fund to assess whether a risk is a principal risk by considering whether a risk would place more than 10 percent of a fund's assets at risk and if it would likely meet this 10 percent threshold in the future. Funds also would have to list their principal risks in order of importance.

ICI’s letter strongly discourages the SEC from implementing this approach because the proposed 10 percent standards require more precision than is possible. In addition, funds may use different methods to meet the 10 percent standards, which will make it difficult for investors to compare funds and will also increase the volume of disclosures, both of which are at odds with the Commission’s policy objective for disclosure reform. Finally, ICI contends these rigid standards are inconsistent with the SEC’s recent principles-based disclosure rulemaking for public companies finalized in August 2020. The Institute urges the Commission to apply this same reasoned approach to fund disclosure (pages 47–49).
