

December 21, 2020

The Honorable Jay Clayton
Chairman
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 Chairman Clayton:

The Investment Company Institute¹ is filing today a [letter](#) in response to the Commission's proposal to improve fund disclosure. I wish to highlight our most significant comments for your consideration.

At the outset, I want to commend you and your staff for the novel approach you took to develop this proposal, basing it on feedback from retail investors in funds to capture their preferences for how to receive and consider investment-related information.² We also developed our comments after accounting for investor preferences. For example, working closely with our members, we created a summary shareholder report and tested it with investors. We then submitted a prototype, and related investor testing results, in our response to the Commission's Retail Investor Experience Release.³

The importance of this work 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

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 \$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 *Request for Comment on Fund Retail Investor Experience and Disclosure*, SEC Release Nos. Release No. 33-10503; 34-83376; IC-33113 (June 5, 2018) ("Retail Investor Experience Release"), available at www.sec.gov/rules/other/2018/33-10503.pdf; *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), available at <https://www.sec.gov/rules/proposed/2020/33-10814.pdf>. We use the term "fund" to refer to mutual funds and exchange-traded funds (ETFs).

³ See Letter from Susan Olson, General Counsel, ICI, to Brent J. Fields, Secretary, SEC, dated October 24, 2018 ("ICI Retail Investor Experience Letter"), available at www.sec.gov/comments/s7-12-18/s71218-4932121-178430.pdf; ICI Research Perspective, *Ownership of Mutual Funds, Shareholder Sentiment, and Use of the Internet, 2020* (November 2020), available at <https://www.ici.org/pdf/per26-08.pdf>.

professionals who assist them, have ready access to the information they want and need in a form they can use.

I strongly believe that a modern fund disclosure system should provide investors with digestible, layered information, delivered in a manner that honors their preferences. We view the Commission's proposal as advancing some, but not all, of these goals. To this end, our letter supports several elements of the proposal and recommends modifying other aspects.

I also underscore that the scope of the Commission's proposal is so far-reaching that we must qualify most of our recommendations because we cannot assess the proposal's overall effect with any certainty. There are so many combinations of disclosure content and delivery mechanisms possible, and each combination potentially will affect firms differently depending on the characteristics of their shareholder populations and disclosure practices.

ICI Supports Modernizing How Funds Deliver Information

We wholeheartedly agree with you that the time has come for the Commission to modernize the framework that governs how funds may deliver information to shareholders, permitting funds to electronically deliver—or e-deliver—information to shareholders while delivering such information in paper via US mail to any shareholder who requests it. Therefore, the Commission should modernize how funds deliver information to shareholders by:

- permitting funds to e-deliver disclosure documents, provided that they permit fund shareholders to request to receive paper documents at any time;
- allowing funds to continue to choose to deliver annual shareholder reports to shareholders consistent with Investment Company Act Rule 30e-3 and limiting this delivery option to funds that choose not to rely on proposed Rule 498B;⁴ and
- allowing funds to satisfy delivery obligations by posting semiannual shareholder reports online.

ICI Supports Allowing Funds to Provide Streamlined Annual Shareholder Reports

We strongly support the Commission allowing funds to use a new streamlined shareholder report with key information in a prescribed order. The content of the streamlined shareholder report aligns with the ICI-recommended summary shareholder report. Our investor testing of the ICI summary shareholder report prototype indicated that investors greatly favored, and would be more likely to read and understand, a shorter shareholder report.⁵

That said, we have significant concerns with requiring funds to include the new “Material Fund Changes” section in the annual shareholder report. The Commission would require a fund to describe briefly any material change that has occurred since the beginning of the reporting period, which, at a minimum, must include changes that are set forth in a Commission-designed, enumerated list of items. One fund, however,

⁴ If the Commission does not follow this recommendation, we recommend that the Commission, at a minimum, retain Rule 30e-3 for some period of time after any disclosure reform package is adopted to allow fund shareholders to reap some benefits of sunk costs incurred to comply with the rule. In any event, we take serious issue with the Commission eliminating a major rule so quickly after so much time and resources have been put towards compliance, a cost that fund shareholders ultimately bear. Our strong preference, therefore, is for the Commission to continue to provide funds with the option of delivering annual shareholder reports consistent with Rule 30e-3.

⁵ 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.

may reasonably view a particular type of change as material while another may not, given differences in, among other matters, the funds' respective investment objectives, holdings, strategies, and risk profile.

We therefore recommend an alternative approach whereby funds (instead of the Commission) would determine which changes to identify.⁶ Consistent with the Commission's approach, we recommend that a fund highlight the changes for shareholders by presenting them in a discrete uniform location in the shareholder report.⁷ We believe this would adequately inform shareholders and, at the same time, provide funds with more certainty as to how to comply with this requirement.

ICI Supports Recalibrating Disclosure of Acquired Fund Fees and Expenses

We strongly support the proposed approach for disclosing acquired fund fees and expenses, or AFFE, but also recommend the Commission not treat business development companies, or BDCs, as acquired funds for purposes of the required fee table presentation. 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, a BDC's expenses are more like an operating company's expenses.

ICI Opposes the Proposed Prospectus Risk Disclosure

We strongly recommend that the Commission retain the current, principles-based approach to risk disclosure in prospectuses rather than requiring funds to disclose principal risks in order of importance and not in alphabetical order. Likewise, we strongly recommend not requiring funds to apply an arbitrary standard such as the proposed 10 percent test approach to determine if a risk is a principal risk.

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.⁸

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. The fund ultimately bears liability for failing to disclose principal risks and therefore has ample incentive to disclose them.

⁶ Shareholders currently receive information about changes in: (i) annual prospectus updates; or (ii) other prospectus updates they may receive throughout the year (*e.g.*, prospectus "stickers"). We recommend that funds continue to determine which changes to disclose using the longstanding analytical framework for determining materiality, which funds apply when deciding whether to file an amendment to a registration statement, which type of amendment to file, or instead to file, and, at times, additionally mail, a sticker.

⁷ Technically speaking, we recommend capturing those changes that would be reflected in an amendment to the fund's registration statement filed pursuant to Rule 485(a) under the Securities Act, which amendment is effective. Our letter explains the basis for this recommendation at length and reflects members' strong preference.

⁸ Form N-1A, Item 4(b)(1) Risk Return Summary: Investment Risks, Principal Investment Strategies, Related Risks, and Disclosure of Portfolio Holdings, Instruction 2.

Moreover, we note that the Commission has taken two diametrically opposed approaches to risk disclosure at the same time: one for public companies and a different one for funds. In August of this year, the Commission adopted amendments to Regulation S-K, stating in the adopting release 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.⁹

We urge the Commission to apply this same reasoned approach to fund risk disclosure as it has for public companies.

We fully support the Commission's efforts to improve fund disclosure and stand ready to assist the Commission as it moves forward. If you have any questions or would like to discuss our comments in detail, please feel free to contact me at 202-326-5824 or (eric.pan@ici.org).

Sincerely,



Eric J. Pan
President & CEO

cc: The Honorable Hester Peirce
The Honorable Elad Roisman
The Honorable Allison Herren Lee
The Honorable Caroline Crenshaw
Dalia Blass, Director, Division of Investment Management

⁹ Modernization of Regulation S-K Items 101, 103, and 105, Securities Act Release No.10825 (August 26, 2020) at 77, available at <https://www.sec.gov/rules/final/2020/33-10825.pdf>.