

MEMO# 31456

October 24, 2018

ICI Letter to SEC on Request for Comment on Retail Investor Experience

[31456]

October 24, 2018 TO: ICI Members
Investment Company Directors
ICI Global Members SUBJECTS: Advertising
Closed-End Funds
Disclosure
Exchange-Traded Funds (ETFs)
Fees and Expenses
Investment Advisers RE: ICI Letter to SEC on Request for Comment on Retail Investor Experience

We filed a [letter](#) with the Commission today commending it for the recent request for comment on enhancing fund disclosure. The letter recommends that the Commission consider proposing a rule creating a new, optional fund summary shareholder report with key information in a prescribed order. We included results from our investor testing of a summary shareholder report prototype that indicate investors would be more likely to read the summary, rather than the full-length, shareholder report. We also strongly encourage the Commission to modernize the delivery of fund prospectuses to give funds the option to send shareholders notices in lieu of summary or full-length prospectuses.

We also make a number of other recommendations that are intended to achieve a balance that permits funds enough flexibility to create a variety of documents that can vary in length and manner of delivery and assure that shareholders can easily access additional information. The letter is summarized below.

Summary Shareholder Report. We recommend that the Commission propose a new, optional summary shareholder report. This summary should include critical information from the full-length shareholder report provided in a specific order, mirroring the Commission's design of the summary prospectus and similarly facilitating comparison of funds. In particular, the summary shareholder report for a fund should include:

- performance highlights;
- total return;
- expenses;
- graphical representation of portfolio holdings;
- operation and effectiveness of its liquidity risk management program over the past

- year; and
- instructions on how to access the full shareholder report.

Consistent with the summary prospectus rule, funds should have the option to use the summary shareholder report and investors should be able to request a full-length shareholder report. Funds also would have the option, under recently adopted Rule 30e-3, to send shareholders a notice to satisfy their obligation to transmit shareholder reports by, among other things, making such reports and other materials accessible on the internet.

ICI created a prototype of a summary shareholder report and tested it using a nationally representative survey that included more than a thousand mutual fund shareholders. More than 90 percent of these mutual fund investors agreed the prototype summary shareholder report is enough to stay informed, is a document they would be more likely to read, and that the more concise document made it easier to compare funds. The survey also included three comprehension-related questions to discern whether the prototype could convey valuable facts about a fund. In fact, a majority of mutual fund investors answered each content-related question correctly using the prototype. We have published the survey results on our website.[\[1\]](#)

We also recommend that the Commission propose a summary shareholder report tailored for closed-end funds requiring the same information as that which appears in the mutual fund summary shareholder report (except for information related to liquidity risk management programs) and, additionally:

- total return based on the market prices of fund shares;
- material changes in any of the following—the fund’s investment objectives or policies, the fund’s principal risk factors, and portfolio managers;
- structural leverage;
- managed distribution policies;
- dividend reinvestment plans; and
- share repurchases.

Appendices to this letter include the prototype summary shareholder report (Appendix A) and a comparison of the information in the full-length shareholder report to that in the summary shareholder report (Appendix B).

Modernizing Delivery of Fund Prospectuses. We strongly recommend that the Commission provide firms with the flexibility to choose to send investors a notice informing investors that summary and full-length prospectuses are available. Doing so will result in significant cost savings for fund shareholders and align much more effectively with shareholder preferences. It also will be consistent with Rule 30e-3, thereby enhancing the coherence of the delivery framework for fund disclosure.

New One-Page Sheet. We strongly oppose the Commission requiring a one-page sheet at the beginning of each prospectus or summary prospectus. Both the summary and statutory prospectuses provide investors with key information. The summary prospectus is a short document by nature and the same key information appears in the front of the statutory prospectus. Funds already produce one-page fact sheets. Thus, there is no information gap to fill.

User-Friendly Display of Information. We recommend that the Commission: (i) allow funds to satisfy federal securities law obligations by providing access to additional information through smartphone applications; (ii) not dictate the content or placement of information

on fund websites and more generally strive to maintain technology-neutral requirements; and (iii) consider initiating a pilot program to allow funds to develop more creative approaches to disclosure accompanied by any necessary safe harbors.

Customized Expense Disclosure. We strongly oppose the Commission requiring funds to provide customized calculations of fund expenses. Along with the fee table in the prospectus, there are fund fee examples in both the prospectus and shareholder report. In addition, there are fund comparison tools, including fee calculators, readily available to investors. A requirement for individualized expense information would have exceptionally high costs, logistical complexity, and is unnecessary because of calculators and other resources already available for investors.

Transaction Cost Disclosure. There is sufficient information about transaction costs in fund disclosure and therefore we do not recommend any changes. Appendix C to this letter describes experiences in the European Union with confusing transaction cost disclosure.

Investment Research Disclosure. We recommend that the Commission continue to require funds to disclose, among other things, how the fund selects brokers and determines the overall reasonableness of brokerage commissions paid and the nature of brokers' research services used by the fund.

Acquired Fund Fees and Expenses. We recommend that the Commission permit funds to exclude business development companies, or BDCs, from "acquired fund" for purposes of the fee table presentation. This would allow funds to treat BDCs in the same manner as investments in operating companies for expense presentation purposes.

Investing Related Expense Disclosure. We recommend that the Commission require funds to disclose investing related expenses (*i.e.*, interest expense and dividends paid on short sales) in the fund's Statement of Additional Information (SAI) (similar to information about brokerage costs) and financial statements rather than in the fee table.

Risk Disclosure. We strongly oppose the Commission requiring funds to disclose a standardized risk measure or risk rating. It would be dangerous for the Commission to create its own risk indicator or encourage an investor to rely on a particular risk indicator. Risk is inherently complex and multi-faceted. There is no single agreed-upon standard measure of risk. Investors can, and do, view risk very differently, (*e.g.*, a retired investor as compared to a recent college graduate). Requiring funds to provide a standardized risk measure at best could be misleading but more likely harmful. Further, the experiences of the European Union and Canada provide object lessons in the hazards of regulators imposing standardized risk measures. We have included an appendix with an analysis of risk rating experiences (Appendix D).

Each fund prospectus includes a bar chart showing the fund's annual returns for 10 calendar years, illustrating graphically the variability of a fund's returns. In addition, each fund must disclose its best and worst returns for a quarter during the 10-year period to show investors in a straightforward manner that the value of fund shares may fluctuate over shorter periods. This disclosure adequately depicts for investors the risk associated with investing in the fund.

Performance. We recommend that: (i) funds continue to be required to provide short-term performance along with medium-term and long-term performance; (ii) funds not be required to disclose how they determined that their benchmark is an appropriate broad-

based securities market index; (iii) the Commission or the staff consider providing more clarity around what constitutes an appropriate broad-based securities market index; (iv) the Commission consider permitting each fund to use an index other than a broad-based securities market index as its primary benchmark; and (v) the Commission retain the current disclosure requirements related to portfolio managers.

We adamantly oppose any proposal which would require funds to compare their fees or performance to other unaffiliated funds. It is simply inappropriate, unduly burdensome, and complex. How would this practically work? Why should a fund's shareholders pay to include this information in their fund's documents? Third-party vendors already track thousands of mutual funds and make these data available for public consumption.

Management's Discussion of Fund Performance. We recommend that: (i) funds be permitted, but not required, to link the management's discussion of fund performance (MDFP) to an on-line video presentation; (ii) funds be required to include in semi-annual shareholder reports' MDFP the 1-, 5-, and 10-year average annual return for the fund and its benchmark; and be permitted, but *not* required, to include the portfolio manager commentary and line graph in the semi-annual shareholder report; and (iii) the Commission continue to provide funds with flexibility to explain factors that materially affected their performance.

Fund Advertisements. The Commission's current regulatory framework for advertisements works well and strikes an appropriate balance. This framework allows funds to provide useful information that is not misleading, yet is abbreviated, as compared to other fund regulatory documents. It is not necessary to: (i) enhance disclosure to better distinguish advertisements and prospectuses; (ii) change requirements for risk and return disclosure; or (iii) require new disclosures depending on fund type.

We urge the Commission to: (i) encourage the Financial Industry Regulatory Authority (FINRA) to permit broker-dealers to provide retail investors with "related performance information;" (ii) modernize the testimonial rule under the Investment Advisers Act of 1940 to facilitate advisers' and funds' use of social media; (iii) allow funds and advisers to calibrate the information provided in advertisements depending on the audience, recognizing that the information needs of retail and institutional investors differ; and (iv) encourage FINRA to amend its requirements to permit streamlined expense information in fund advertisements. These four initiatives will further promote an enhanced investor experience and more informed decision-making.

Closed-End Funds. We recommend that the Commission: (i) not develop a summary prospectus for non-continuously offered closed-end funds; (ii) consider requiring closed-end funds to provide an MDFP and improve the presentation of performance in shareholder reports; and (iii) modernize delivery of Section 19(a) notices.

Future Commission Initiatives. We support the Commission exploring enhanced investor testing, pilot programs to test potential disclosure alternatives, and the use of roundtables or committees to engage investors and market participants on fund disclosure matters. We caution however that the Commission should not give the same weight to such small-sample non-representative exercises as a nationally representative survey research effort.

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endnotes

[1] The survey results are available in the *ICI White Paper*, “Mutual Fund Investors’ Views on Shareholder Reports: Reactions to a Summary Shareholder Report Prototype,” available at https://www.ici.org/pdf/ppr_18_summary_shareholder.pdf.

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