

MEMO# 31968

September 16, 2019

SEC Staff Encourages Funds to Improve Their Principal Risk Disclosures for Investors

[31968]

September 16, 2019 TO: Chief Compliance Officer Committee

Chief Risk Officer Committee

Compliance Advisory Committee

SEC Rules Committee RE: SEC Staff Encourages Funds to Improve Their Principal Risk Disclosures for Investors

On September 9, 2019, the Disclosure Review and Accounting Office within the SEC's Division of Investment Management published Accounting and Disclosure Information related to how funds disclose their principal risks.[\[1\]](#) According to the ADI, the staff has noticed that some funds provide principal risk disclosures "that are overly lengthy and technical," which can make it difficult for investors to understand them. The ADI discusses three recommendations from the staff that may improve these disclosures. These three are:

1. **Ordering Risk by Importance.** The staff "strongly encourages all funds" to list their principal risks "with the most significant risk appearing first." It notes that, if a fund instead uses an alphabetical approach, it may "obscure the importance of key risks." Recognizing that the recommended approach "requires subjective determinations," the ADI notes that "the staff believes that funds are best positioned to make these judgments of relative importance" and they "would not generally expect to comment on the fund's ordering."
2. **Tailoring Risk Disclosures.** The staff "encourages funds to tailor risk disclosures to more closely describe the principal risk associated with an investment in that particular fund." This recommendation is to avoid funds relying on "generic, standardized, risk disclosures across funds" rather than tailoring such disclosure to how the particular fund operates.
3. **Disclosing that a Fund is Not Appropriate for Certain Investors.** The staff also encourages "funds to consider disclosing that a fund *is not* appropriate for certain investors given the fund's characteristics."[\[2\]](#)

In addition to these three recommendations, the ADI notes that "the staff wishes to remind funds of measures they can take to improve their risk disclosure so as to provide investors clear, concise, relevant, and timely information." The three measures cited are:

- Remembering that the intent of a summary prospectus is to provide summary information. More detailed information about the fund's risks should appear elsewhere in the prospectus;
- Non-principal risks and non-principal investment strategies should be in the fund's statement of additional information rather than in the fund's prospectus; and
- Funds should periodically review their risk disclosures – including the order of their risks – to determine whether they “remain adequate in light of the fund's characteristics and market conditions.”

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endnotes

[1] See ADI 2019-08, *Improving Principal Risks Disclosure*, which is available at: <https://www.sec.gov/investment/accounting-and-disclosure-information/principal-risks/adi-2019-08-improving-principal-risks-disclosure>. According to the ADI, “ADIs are recurring publications that summarize the staff's views regarding various requirements of the federal securities laws.” The statements in them “represent the views of the Division of Investment Management” and they are “not a rule, regulation or statement of the [SEC].” ADI at p. 2.

[2] An example of this, according to the ADI, is a fund designed for long-term investors being sold to an investor with a short-term horizon. According to the ADI, “highlighting this information may assist investors in making better informed decisions in line with their investment goals.”