

MEMO# 32659

August 5, 2020

SEC Proposes Disclosure Reform

[32659]

August 5, 2020 TO: Accounting/Treasurers Committee
Advertising Compliance Advisory Committee
Closed-End Investment Company Committee
Disclosure Working Group
ETF Advisory Committee
Operations Committee
SEC Rules Committee
Small Funds Committee
Transfer Agent Advisory Committee
Unit Investment Trust Committee
Variable Insurance Products Advisory Committee RE: SEC Proposes Disclosure Reform

The SEC today proposed comprehensive modifications to the mutual fund and ETF disclosure framework.[\[1\]](#) The proposed disclosure framework would feature a summary shareholder report that would highlight information that the Commission considers as particularly important for retail investors to assess and monitor their fund investments. The proposal is a central component of the Commission's 2018 investor experience initiative. In response to that Commission initiative, ICI created and conducted investor testing of a prototype summary shareholder report in 2018, and investors indicated that they would be more likely to read the summary than the full-length shareholder report, while also finding the summary helpful to compare different funds.[\[2\]](#)

Comments on the proposal will be due 60 days after publication in the *Federal Register*. We will be scheduling a member call to discuss the proposal in the near future.

The proposal would:

- require streamlined reports to shareholders that would include, among other things, fund expenses, performance, illustrations of holdings, and material fund changes;
- encourage funds to use graphic or text features—such as tables, bullet lists, and question-and-answer formats; and
- promote a layered and comprehensive disclosure framework by continuing to make available online certain information that is currently required in shareholder reports but may be less relevant to retail shareholders generally.

Under the proposal, instead of receiving prospectus updates and semi-annual and annual

shareholder reports, existing investors would receive streamlined annual and semi-annual shareholder reports. Information currently required in shareholder reports that is not included in the streamlined shareholder report would be available online, delivered free of charge upon request, and filed on a semi-annual basis with the Commission. In addition, the proposal would amend prospectus disclosure requirements regarding fees, expenses, and principal risks.

Streamlined Shareholder Reports

The streamlined shareholder report would highlight information that is particularly important for retail shareholders to assess and monitor their fund investments, including fund expenses, performance, illustrations of holdings, and material fund changes. The proposal would encourage open-end funds to use graphic or text features—such as tables, bullet lists, and question-and-answer formats. It would also provide flexibility for open-end funds to make electronic versions of their shareholder reports more user-friendly and interactive.

The proposed amendments would require the Management's Discussion of Fund Performance (MDFP) to include additional performance-related information in a shareholder report (that currently is available in fund prospectuses), including certain class-specific performance information and comparative information showing the average annual total returns of one or more relevant benchmarks.^[3] The proposal would amend the definition of an appropriate broad-based securities market index to clarify that all funds should compare their performance to the overall applicable securities market, for purposes of both fund annual reports and prospectuses

The proposal also would continue to encourage a fund to include narrower indexes that reflect the market segments in which the fund invests in its performance presentation along with its appropriate broad-based securities market index. If a fund invests in both equity and debt securities, such as a balanced fund, the proposal would permit the fund to include more than one appropriate broad-based securities market index. The fund also would be permitted to include a blended index—one that combines the performance of more than one index, such as equity and debt indexes—as an additional index to supplement the appropriate broad-based securities market index(es) that the fund includes.

Availability of Additional Information on Form N-CSR and Online

Under the proposal, certain information in an open-end fund's annual and semi-annual shareholder reports that the Commission considers less relevant to retail shareholders would be available online, delivered free of charge upon request, and filed on a semi-annual basis with the Commission on Form N-CSR. This information would include, for example, the schedule of investments and other financial statement elements.

Delivery of Information to Fund Investors

Currently, open-end fund shareholders generally receive an updated annual prospectus each year. Proposed new rule 498B would provide an alternative approach to keep investors informed about their fund investment and any fund updates that occur year over year. Under the proposed rule, new investors would receive a fund prospectus in connection with their initial investment in an open-end fund, as they currently do, but funds would not deliver annual prospectus updates to shareholders thereafter. Instead, under the proposed layered disclosure framework, funds would keep shareholders informed through the shareholder report (including a summary in the annual report of material changes over the prior year), as well as timely notifications of material fund changes as they occur.

Current versions of the fund's prospectus would remain available online and would be delivered upon request in paper or electronically, consistent with the shareholder's delivery preference.

Amendments to Scope of Rule 30e-3 to Exclude Open-End Funds

Under the existing framework, beginning as early as January 1, 2021, funds may begin relying on rule 30e-3. This rule generally permits funds to satisfy shareholder report transmission requirements by making these reports and other materials available online and providing a notice of the reports' online availability, instead of directly providing the reports to shareholders. Investors who prefer to receive the full reports in paper may—at any time—choose that option free of charge.

In a major change, the proposal would amend the scope of rule 30e-3 to exclude open-end funds. The proposal would not affect the availability of rule 30e-3 for other registered management companies (such as registered closed-end funds) or registered unit investment trusts.

According to the Commission, this amendment would help ensure that all open-end fund shareholders would experience the anticipated benefits of the proposal's modified disclosure framework, which contemplates direct transmission of concise shareholder reports that serve as the central source of fund disclosure for existing shareholders. The proposed framework is designed to provide a more effective means for investors to access and use fund information, while continuing to recognize investor delivery preferences and reducing expenses associated with printing and mailing.

Improvements to Prospectus Disclosure of Fund Fees and Risks

The proposal would amend open-end fund prospectus disclosure to (1) replace the existing fee table in the summary section of the statutory prospectus with a simplified fee summary, (2) move the existing fee table to the statutory prospectus, for use by investors seeking additional details about fund fees, and (3) replace certain terms in the current fee table with terms that may be clearer to investors.

The proposal would amend open-end fund prospectus risk disclosure by (1) promoting the disclosure of a fund's principal risks, rather than additional, often overwhelming, disclosures about non-principal risks, and (2) tailor principal risk disclosure by specifying how principal risks can be assessed.

Acquired Fund Fees and Expenses

The proposed amendments also would refine current requirements for funds to disclose the "acquired fund fees and expenses" associated with investments in other funds. Specifically, the proposal would permit open-end funds that make limited investments in other funds to disclose the fees and expenses associated with those investments in a footnote to the fee table and fee summary, rather than as a fee table line item.

Investment Company Advertisements Presentation of Fee and Expense Information

The proposal would require that investment company advertisements providing fee and expense figures include: (1) the maximum amount of any sales load, or any other nonrecurring fee; and (2) the total annual expenses without any fee waiver or expense reimbursement arrangement (collectively, the "required fee and expense figures"). This proposed requirement would only apply if an investment company advertisement includes

fee or expense figures, and therefore an advertisement would not need to include the required fee and expense figures if it only included general, narrative information about fee and expense considerations and did not include any numerical fee or expense amounts.

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endnotes

[1] The SEC proposal is *available at* <https://www.sec.gov/rules/proposed.shtml>. A mockup of a streamlined shareholder report is *available at* https://www.sec.gov/files/final_2020_im_annual-shareholder%20report.pdf. A chart illustrating the differences between the current disclosure framework and the proposed framework is *available at* <https://www.sec.gov/image/tailoredshareholderreports>.

[2] ICI's comment letter on the retail investor experience is *available at* <https://www.sec.gov/comments/s7-12-18/s71218-4932121-178430.pdf>

[3] The MDFP would be required to appear in the annual, not the semi-annual shareholder report. Funds would be permitted to voluntarily include the MDFP in semi-annual shareholder reports.