

**MEMO# 33001**

December 21, 2020

# ICI Submits Comment Letters on the SEC's Disclosure Reform Proposal

[33001]

December 21, 2020 TO: ICI Members  
Investment Company Directors SUBJECTS: Advertising  
Closed-End Funds  
Disclosure  
Exchange-Traded Funds (ETFs)  
Fees and Expenses  
Fund Accounting & Financial Reporting  
Fund Governance  
Money Market Funds  
Operations  
Transfer Agency  
Unit Investment Trusts (UITs) RE: ICI Submits Comment Letters on the SEC's Disclosure Reform Proposal

As we previously informed you, the SEC proposed comprehensive modifications to the mutual fund and ETF disclosure framework.[\[1\]](#) ICI filed two comment letters today responding to the proposal.[\[2\]](#)

ICI's letter commends the SEC for examining the disclosure preferences of retail investors in registered investment companies and developing a proposal intended to give investors the disclosure they need to make informed investment decisions. ICI states that the SEC now has the opportunity to leverage technology to enhance investor disclosure – providing investors with digestible, layered information and choice. It further states that a guiding principal should be that investor preferences are honored and facilitated—whether they prefer to read full-length or summary disclosure documents in paper, in electronic format, or receive notice that fund documents are available online.

The Commission's proposal would advance some, but not all, of these goals. ICI therefore supports several elements of the proposal and recommends modifying other aspects. ICI also strongly encourages the Commission to modernize the ability of funds to deliver information electronically to shareholders ("e-delivery").

The letter notes that the proposal would reform dramatically the mosaic of requirements that govern how funds deliver information to investors. Certain members concluded that the breadth of the changes to the current disclosure system and the significant costs that

would be involved to implement them outweigh the anticipated benefits. These members, while expressing a minority view, strongly prefer that the SEC move forward to facilitate e-delivery, but not adopt other proposed changes (including not eliminating Rule 30e-3).

ICI's letter provides detailed recommendations, reflecting the views that most of its members share. In the letter, ICI strongly recommends that the Commission:

- permit funds to e-deliver disclosure documents to fund shareholders while permitting any shareholder to request at any time that the documents be delivered in paper;
- retain Investment Company Act Rule 30e-3 as optional for open-end investment companies; and
- allow funds to satisfy delivery obligations by posting semiannual shareholder reports online.

The remainder of ICI's comments are summarized below.

## **Key Comments**

### ***Manner of Delivering Fund Disclosure to Shareholders***

As described above, the Commission should facilitate e-delivery, allow open-end funds to continue to rely on Rule 30e-3, and permit funds to satisfy their semiannual shareholder report transmission obligations by filing them with the SEC, posting them online, and delivering them upon request to shareholders in a manner consistent with the shareholder's delivery preference (*i.e.*, paper or email).

We support Rule 498B only as an optional rule and recommend limiting its availability to funds that choose not to rely on Rule 30e-3. Some of its proposed provisions present significant issues and thus, as currently drafted, its widespread adoption is highly unlikely. To increase its utility, we recommend that the SEC:

- rename the "Material changes to the fund" section set forth in proposed Rule 498B(c)(2) to "What Has Changed;"
- require that funds mail notices to shareholders in accordance with Item 27A(g) of Form N-1A, subject to our significant recommended changes to that Item; and
- require funds to deliver notice of certain changes "as soon as reasonably practicable but no later than fourteen business days" after the change has occurred.

### ***Litigation Risk***

The Commission should include statements in any adopting release that make clear that by adopting new or additional requirements, or permitting or encouraging certain additional disclosures or use of tools (rather than requiring them), it is not intending to change the "total mix of information" doctrine that has successfully protected fund shareholders from bearing the costs associated with defending against meritless litigation.

### ***Content of Disclosure***

*Streamlined Shareholder Report.* We generally support the SEC's proposed streamlined shareholder report. We recommend certain targeted changes to the proposed

requirements. The SEC should:

- revise the definition of “appropriate broad-based securities market index” to focus on the “appropriateness” of the benchmark index, which would produce more apt and useful performance comparisons for investors;
- rename proposed Item 27A(g) of Form N1A entitled “Material Fund Changes” to “What Has Changed” and require funds to briefly describe changes that have occurred since the beginning of the reporting period with respect to which the fund has filed an amendment to its registration statement pursuant to Rule 485(a), which amendment is effective;
- modify the liquidity risk management disclosure item to (i) require funds to provide this liquidity disclosure in the streamlined shareholder report only if they do not (a) meet the definition of “In-Kind ETF” or “primarily highly liquid fund” under the liquidity rule, or (b) consistently hold a majority of their assets in highly liquid investments; and (ii) simplify the instruction to produce more useful information about a fund’s liquidity risk profile;
- exempt funds offered exclusively to other funds from the obligation to prepare and transmit shareholder reports; and
- permit all of the fund complex’s variable annuity funds, target date funds, target risk funds, money market funds, and state tax-exempt funds respectively to be bundled in a single shareholder report.

*Proposed Prospectus Disclosure Changes.* We support some, but not all, of the proposed disclosure changes as described below.

- We strongly oppose the proposed fee summary and recommend that the SEC retain the existing fee table as Item 3 of Form N-1A.
- We recommend the SEC test the proposed fee table terminology changes with shareholders before proceeding but we also recommend retaining the existing terminology to describe fee waivers, distribution fees and redemption fees.
- We support the proposed approach for disclosing acquired fund fees and expenses, or AFFE, but we also recommend excluding business development companies, or BDCs, from the definition of acquired funds.
- We recommend excluding performance-related expenses such as interest expense on borrowings from the fee table expense ratio.
- We strongly recommend retaining the current, principles-based approach to risk disclosure rather than requiring funds to disclose principal risks in order of importance.
- We strongly oppose a requirement that funds apply the proposed 10 percent test approach in the first instance to determine if a risk is a principal risk in place of today’s principles-based approach to risk disclosure.
- We strongly recommend permitting funds to list principal risks in alphabetical order.

## **Miscellaneous Comments**

- The SEC should maintain its current advertising regulatory framework rather than

partially duplicating the Financial Industry Regulatory Authority, or FINRA, requirements (which have provisions related to fees and expenses in retail communications) in SEC rules.

- The SEC should permit funds to disclose in each shareholder report the website address where shareholders can find information about the sources of distributions paid, in lieu of requiring a separate written notice to accompany the distribution.
- The SEC should lengthen the compliance period from 18 to 24 months.

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#### **endnotes**

[1] See ICI Memorandum No. 32660 (August 5, 2020), *available at* [https://www.ici.org/my\\_ici/memorandum/memo32660](https://www.ici.org/my_ici/memorandum/memo32660). The SEC's proposal is *available at* <https://www.sec.gov/rules/proposed.shtml>.

[2] A copy of ICI's comprehensive comment letter is *available at* [https://www.ici.org/pdf/20\\_ltr\\_disclosure.pdf](https://www.ici.org/pdf/20_ltr_disclosure.pdf) and a copy of a letter Eric Pan, President & CEO sent to SEC Chairman Jay Clayton relaying our most significant comments is *available at* [https://www.ici.org/pdf/20\\_ltr\\_disclosurecover.pdf](https://www.ici.org/pdf/20_ltr_disclosurecover.pdf). The remainder of the memorandum summarizes the comprehensive comment letter.