

MEMO# 29781

March 22, 2016

SEC Publishes Guidance on the Importance of Fund Disclosure Reflecting Risks Related to Current Market Conditions

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TO:

CHIEF RISK OFFICER COMMITTEE No. 6-16
COMPLIANCE MEMBERS No. 5-16
INTERNAL AUDIT COMMITTEE No. 4-16
SEC RULES MEMBERS No. 12-16
SMALL FUNDS MEMBERS No. 9-16

RE:

SEC PUBLISHES GUIDANCE ON THE IMPORTANCE OF FUND DISCLOSURE REFLECTING RISKS RELATED TO CURRENT MARKET CONDITIONS

The SEC's Division of Investment Management has published a Guidance Update relating to the importance of fund disclosure reflecting risks related to current market conditions." [\[1\]](#) As with the Division's previous Guidance Updates, this one is intended to communicate what actions the staff believes funds should be taking in the interest of fostering investor protection. With respect to fund disclosures, "the staff believes that funds should review their risk disclosures on an ongoing basis and consider whether [they] remain adequate in light of current conditions." [\[2\]](#) The substance of this Guidance is summarized below.

The Guidance begins by noting the "importance of risk disclosures to investors." It then notes that, while the staff has previously provided guidance on various aspects of risk disclosures on a number of occasions, the current Guidance "is intended to address another

important aspect of fund risk disclosure, namely, the changes in a fund's susceptibility to risk that may result in changes in market conditions and the need for funds to review and assess risk disclosures in light of changing market conditions." [3] It additionally notes the staff's understanding "that many fund boards request that the fund's adviser report to the board on its processes for preparing the fund's disclosure materials" and, as part of this process, "the staff believes that a fund's adviser should consider providing information to the fund board on the steps taken by the adviser to evaluate fund risk disclosures and consider whether changes are appropriate." [4]

According to the staff of the Division, taking three steps "on an ongoing basis should help funds in providing disclosure to investors that remain robust in changing market conditions." These three steps are:

1. Monitoring Market Conditions and their Impact on Fund Risks; [5]
2. Assessing Whether Fund Risks Have Been Adequately Communicated to Investors in Light of Current Market Conditions; [6] and
3. Communicating with Investors.

With respect to 3., the Guidance notes that, if a fund determines that changes in current market conditions have resulted in changes to the fund's risk that are material to investors and its current disclosures do not adequately communicate those changes, it "should provide any such updated communications to investors, at the time and in the manner required by the federal securities laws and as otherwise appropriate." Such updates might be communicated via the prospectus (for example, "when the fund determines that the risk disclosure in its prospectus would be materially misleading") or shareholder reports, as well as through "less formal methods, such as website disclosure and letters to shareholders." [7]

The Guidance discusses the staff's observations of instances where, in reviewing fund disclosure concerning risk, it has observed funds updating their risk disclosures to address current market conditions. Such updated disclosures have highlighted "current conditions in a manner that [the staff believes] can make risk disclosures more timely, more meaningful, and more complete." The instances cited by the staff involve funds updating risk disclosure relating to:

- Fixed Income Funds – i.e., the impact on fixed income funds from the elimination of quantitative easing and an increase in the Federal funds rate by the Federal Reserve Board;
- Interest Rate Risk – i.e., the increased risk that may result from changes in the historically low interest rates, which might result in a decline in the value of fixed income investments held by a fund;
- Liquidity Risk – i.e., the volatility and increased rate of redemptions that might result from potential rises in interest rates and the impact of this on fund portfolios;
- Duration Risk – i.e., the impact on longer-term securities from interest rate changes; and
- Puerto Rico Debt – i.e., the impact that might result to those funds holding Puerto Rican debt if Puerto Rico defaults on its obligations.

After highlighting the above instances where funds have revised their disclosure to provide "useful information to their investors regarding current market conditions," the Guidance concludes by encouraging "funds to review their risk disclosures on an ongoing basis and consider whether [their] disclosures remain adequate in light of current conditions." [8]

endnotes

[1] See Fund Disclosure Reflecting Risks Related to Current Market Conditions, IM Guidance Update No. 2016-02 (March 2016) (“Guidance”), which is available on the SEC’s website at: <http://www.sec.gov/investment/im-guidance-2016-02.pdf>.

[2] Guidance at p. 1.

[3] Id.

[4] Guidance at p. 2.

[5] According to the Guidance, such monitoring “is, of course, a part of prudent portfolio management by the adviser, so [the staff] would expect that funds would routinely engage in this practice as a normal part of day-to-day operations.” Guidance at p. 2.

[6] The Guidance notes that, if the changing market conditions would have a material impact on investors, the fund “should consider whether its existing disclosures are adequate in light of the changed conditions.” Guidance at p. 3.

[7] Id.

[8] Guidance at p. 6.