

MEMO# 34310

October 12, 2022

ICI Submits Supplemental Comments on the SEC's 2020 Disclosure Proposal Related to Performance Benchmarks

[34310]

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TO: ICI Members

Investment Company Directors SUBJECTS: Advertising
Compliance
Disclosure

Exchange-Traded Funds (ETFs)

Fund Accounting & Financial Reporting

Fund Governance

Investment Advisers RE: ICI Submits Supplemental Comments on the SEC's 2020 Disclosure Proposal Related to Performance Benchmarks

Earlier this week, ICI submitted supplemental comments (linked below) on the SEC's 2020 disclosure proposal for open-end funds ("funds").[\[1\]](#) On September 15, the SEC's Office of the Investor Advocate filed with the SEC a research paper on funds' choice of performance benchmarks and related impacts on investor decision-making.[\[2\]](#)

Our latest comments focus on this research paper. While its survey results provide some useful insights, the limitations and methodological choices of the paper's analysis of funds' benchmark selections significantly undermine its value. We describe the paper's shortcomings and urge the SEC to consider our comments alongside the research paper.

The research paper's survey work confirms the importance of performance benchmarks to investors, which is consistent with our own survey work.[\[3\]](#) Indeed, we addressed this subject extensively in our 2020 comment letter on the proposal[\[4\]](#) and again in response to the SEC's request for comment on information providers[\[5\]](#) precisely because of the importance of performance benchmarks to investors.

However, the research paper also appears to support the proposal's policy preference to mandate that all funds use "broad-based" indexes as performance benchmarks,[\[6\]](#) yet that policy choice fails to appropriately take into account the diversity among the 11,394 long-term open-end funds. If adopted as proposed, the SEC's changes to funds' performance benchmark requirements would provide funds with less discretion in choosing their broad-

based benchmarks and, accordingly, investors with less relevant performance information.

In our letter, we first summarize the SEC's current and proposed performance disclosure requirements and reiterate our prior comments on them. We then analyze the research paper's findings and methodologies and find that:

- The paper contains some constructive findings. For instance, the underlying results do not find evidence that survey participants believed that the broad benchmark is a better reference point than the narrow benchmark.
- In the paper's attempt to "provide further descriptive evidence on the potential for strategic behavior by funds in benchmark disclosure" (Section 7), its reclassification of funds' actual primary and secondary benchmark determinations based on their correlations to the S&P 500 Index is a misguided methodological choice. This choice, in fact, obscures actual fund benchmark selection behavior and therefore provides an unreliable assessment of that behavior.
- In any event, the evidence in Section 7 for any claim that broad (primary) benchmarks are superior to secondary benchmarks is weaker and more mixed than suggested by the paper's summary in Section 8. In key places, the econometric results in Section 7 argue against generalized claims of superiority of broad-based benchmarks, and against the notion that funds use secondary benchmarks strategically to boost their attractiveness to investors, as Section 8 suggests.

We also explain that:

- The research paper's focus on actively managed equity funds limits its usefulness when considering the broad array of fund types to which Form N-1A's requirements apply (e.g., index funds and funds of funds).
- In places, the paper appears to press for greater adoption of the S&P 500 Index as equity funds' primary benchmark, which would be bad policy (funds are too diverse in their investment portfolios and strategies for one or even several indexes to be universally appropriate) and economically problematic (de facto SEC endorsement of certain indexes would create market distortions and likely increase fund licensing costs).
- The research paper does not address the costs that funds incur in including index information in their prospectuses and shareholder reports, or how these costs might change if the SEC's requirements change.

Finally, on procedure, we explain that generally we have no objection to the SEC leaving this comment file open and taking public feedback for a reasonably practicable period. The recent flood of SEC rule proposals and their short comment periods make such an approach valuable in ensuring the Commission receives adequate public comment.[\[7\]](#) In this case, however, we have serious concerns because it is the SEC staff adding to the comment file a mere month before the SEC's target completion date of October for this rulemaking. If the SEC adopts rule and Form amendments in October as planned, the public would have had little opportunity to comment on SEC staff work that could shape any final Commission actions.

In cases where SEC staff submit materials to an open comment file, we state that the SEC should (i) proactively publicize the new material, and (ii) provide sufficient time for public responses to SEC staff work to inform the SEC's rulemaking process. In such circumstances, the Commission also should consider re-opening the comment period for the public.

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Notes

[1] Tailored Shareholder Reports, Treatment of Annual Prospectus Updates for Existing Investors, and Improved Fee and Risk Disclosure for Mutual Funds and Exchange-Traded Funds; Fee Information in Investment Company Advertisements, SEC Release Nos. 33-10814; 34-89478; IC-33963 (Aug. 5, 2020) (the "proposal"), available at www.sec.gov/rules/proposed/2020/33-10814.pdf.

[2] How do Consumers Understand Investment Quality? The Role of Performance Benchmarks, SEC Office of the Investor Advocate (the "research paper"), available at www.sec.gov/comments/s7-09-20/s70920-20142980-308757.pdf.

[3] See Holden, Sarah, Michael Bogdan, and Daniel Schrass. 2022. "What US Households Consider When They Select Mutual Funds, 2021." ICI Research Perspective 28, no. 3 (April), available at <https://www.ici.org/system/files/2022-04/per28-03.pdf>.

[4] See Letter from Susan Olson, General Counsel, and Dorothy Donohue, Deputy General Counsel, ICI, to Vanessa A. Countryman, Secretary, SEC, dated Dec. 21, 2020, at 21-27, available at www.sec.gov/comments/s7-09-20/s70920-8186011-227164.pdf.

[5] Request for Comment on Certain Information Providers Acting as Investment Advisers, SEC Release Nos. IA-6050; IC-34618 (June 15, 2022), available at www.sec.gov/rules/other/2022/ia-6050.pdf. See Letter from Susan Olson, General Counsel, and Matthew Thornton, Associate General Counsel, ICI, to Vanessa Countryman, Secretary, SEC, dated August 16, 2022, at 28-31, at www.sec.gov/comments/s7-18-22/s71822-20136148-306949.pdf.

[6] In the investment management context, an index is a list of securities and/or instruments with associated weightings that is designed to represent, measure, or track the performance of a particular financial market (e.g., a stock, bond, or commodity market) or subset of it. An index may serve as a benchmark against which to evaluate a fund's investment performance.

[7] In April, ICI, along with several other trade associations, submitted a letter to Chair Gensler pointing out that aside from the sheer volume of rulemaking items, the Commission simultaneously was tackling issues that could result in significant shifts in industry operations and practices. The letter also pointed out that "exceedingly short comment periods associated with numerous concurrent potentially interconnected rule proposals that touch on significant changes to the operational and regulatory regime applicable to financial firms could result in rules that hurt investors, damage the financial system, implicate the Commission's obligations under the [Administrative Procedure Act] and internal rulemaking guidelines, and ultimately violate the Commission's tripartite mission." Letter to SEC Chair Gensler (April 5, 2022), available at

www.ici.org/system/files/2022-04/22-ici-letter-to-sec-chair-gensler.pdf.

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