**COMMENT LETTER**

February 2, 1998

# Comment Letter on SEC Proposed New Rule Regarding Delivery of Disclosure Documents to Households, February 1998

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Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: Delivery of Disclosure Documents to Households
File No. S7-27-97

Dear Mr. Katz:

The Investment Company Institute[1] appreciates the opportunity to comment on proposed Rule 154 under the Securities Act of 1933, and amendments to rules under the Securities Exchange Act of 1934 and the Investment Company Act of 1940, that would allow issuers to satisfy their disclosure obligations under the federal securities laws with respect to two or more investors sharing the same address by sending a single document, subject to certain conditions.[2] The ICI supports the underlying goals of the Commission's proposal: to "provide greater convenience for investors and cost savings for issuers by reducing the amount of duplicative information that investors receive."[3] Nevertheless, certain changes should be made to the proposal in order to increase economic efficiencies and more accurately reflect investor expectations.

## Background

As described in the Proposing Release, the Securities Act generally prohibits an issuer or underwriter from delivering a security for sale unless a prospectus meeting certain requirements accompanies or precedes the security.[4] If several persons purchase the same security and share the same household, these requirements may result in the mailing of multiple copies of the same prospectus to a single household. Because, in practice, many mutual funds send updated prospectuses annually to all of their shareholders, sending multiple copies of the same prospectus to a single household is especially problematic for

the mutual fund industry. For example, the same mutual fund may be used as an investment vehicle for a family member's individual retirement account, 401(k) or other tax-deferred retirement account, non-retirement investment account, and trust accounts established for the family's children. In addition, mutual funds, closed-end investment companies, and certain unit investment trusts are required by Rules 30d-1 and 30d-2 under the Investment Company Act to send reports semiannually to their security holders.

ICI members report that among the most frequent complaints that they receive from shareholders are those concerning the delivery of multiple copies of the same disclosure document to the same household. Shareholders note that this practice results in a waste of paper, is environmentally unfriendly, and unnecessarily increases printing and mailing costs, which are ultimately borne by the shareholders themselves. Many industry members are already householding semiannual reports pursuant to prior Commission staff no-action letters,5 and have received substantial support and encouragement from investors for doing so.

The industry therefore applauds the Commission's continued efforts to reduce waste, eliminate delivery of duplicative information and reduce costs. 6 However, we believe that these goals can be achieved in a more efficient manner without diminishing shareholder interests if certain changes are made to the proposal. Most importantly, the proposal's notice and consent requirements should be revised to allow householding so long as notice is given in the prospectus. Additionally, the delivery requirements should be revised to permit greater flexibility in addressing shareholder communications. Certain other technical changes also should be made. At the very least, if the Commission does not believe that our recommended approach is appropriate with respect to prospectuses and shareholder reports sent to non-mutual fund shareholders, this approach should be permitted for such documents sent to mutual fund shareholders. Our specific recommendations are outlined below.

## Notice and Consent Requirements

Under the proposal, a person delivering a single prospectus in reliance on Rule 154 would have to either notify or obtain the written consent of the investors who share an address, depending on the circumstances. The proposal would permit a notice procedure for certain investors who established accounts prior to the effective date of the rule. The notice procedure would be available only for investors who share the same last name or who are reasonably believed to be members of the same family, and who also share a residence. The proposal would require actual written consent for investors who establish accounts after the effective date of the rule or who otherwise do not qualify for the notice procedure.

The notice and consent requirements under proposed Rule 154 would present burdensome and unnecessary hurdles to householding. Accordingly, the Commission should adopt a more workable approach to providing investors with notice of the intent to household that will more effectively create the efficiencies that the householding proposal is intended to achieve. Specifically, Rule 154 should (1) not require written consent from investors, (2) allow issuers to provide notice in their prospectuses, rather than in a separate mailing, and (3) not require notice or consent in the case of multiple accounts held by the same individual.

The Institute strongly believes that, except with respect to the electronic delivery of documents, Rule 154 should not require written consent from investors under any

circumstances. Instead, proposed Rule 154 should be modified to require that persons relying on the rule provide notice (as described below) to all investors (regardless of when they established their accounts) if such persons intend to household prospectuses and other shareholder communications.[7] Such a notice requirement would adequately protect investors' interests, and avoid imposing unnecessary costs and burdens on issuers. As discussed above, ICI members report that shareholders typically complain about receiving multiple copies of prospectuses, shareholder reports and other documents more than almost any other subject. ICI members rarely, if ever, receive a complaint for not sending more than one copy of a shareholder communication to the same address.

Moreover, the written consent requirements seem to be based upon an incorrect premise that it will be relatively easy to obtain the consent of investors in the customer agreement. While it may be possible to include householding consent provisions in customer agreements after the effective date of the rule, these provisions would not cover investors that established accounts prior to the effective date of the rule and that are ineligible for the notice procedure, nor would they cover investors that do not sign customer account agreements with mutual funds. For example, mutual funds whose shares are sold through broker-dealers do not have privity of contract with the investors that purchase shares through such broker-dealers. In some cases, the account of an investor that purchased mutual fund shares through a broker-dealer may be transferred to the books of the mutual fund itself without the investor entering into a new account agreement with the fund, which then becomes responsible for sending prospectuses and shareholder reports to the investor. In both cases, mutual funds have no way of knowing whether the original broker-dealer agreements included provisions allowing the funds to household investor documents.[8] Additionally, investors normally are not required to sign a new account agreement when purchasing shares of a new fund through an exchange of existing shares of another fund in the same complex.[9]

As a result, even after the effective date of the rule, mutual funds would not be able to obtain many investors' written consents to householding through signed account agreements. Instead, they would have to try to obtain written consents through separate mailings to investors. In addition to being extremely expensive, such efforts to obtain written consents usually are ineffective. One ICI member has estimated based on prior experience that only 10 to 15 percent of investors to which such solicitations were made would actually sign and return the consents. The costs associated with attempting to obtain written consents to householding would likely far outweigh the benefits from those consents ultimately obtained. In fact, many of our members have informed us that, if the written consent requirements are not eliminated, householding of prospectuses will become a "dead letter" due to its excessive costs.

The Institute objects in particular to the condition that the notice procedure may only be used for persons who share the same last name or otherwise are members of the same family should be eliminated. It has become quite common in recent years for individuals to share households without sharing the same last name or otherwise belonging to the same family. For example, many married women no longer take their husbands' last names. Under the proposal, persons relying on the rule would have to establish that such women were married to their husbands before being able to use the notice procedure, which would substantially increase mutual funds' costs and in many cases make householding such a married couple cost-prohibitive. Moreover, persons often do not marry for personal reasons or because state laws do not allow them to marry. At the very least, the proposal should not discriminate against such family groups and households in this manner.

Second, the Commission should revise the notice procedures contained in proposed Rule 154. Currently, the rule would permit householding for certain investors who have established accounts prior to the effective date of the rule only if they are provided with a separate written notice at least 60 days prior to initial reliance on the rule that future prospectuses will be delivered to only one person who shares the address. Rather than requiring a separate written notice to each investor, the rule should require simply that a notice of the intent to household (and the steps an investor needs to take to opt out of householding) be disclosed in the prospectus. Thus, once an investor receives a prospectus for a mutual fund at the time he or she makes his or her initial purchase of fund shares, and the prospectus contains the required disclosures, householding should be allowed thereafter. This approach is consistent with the conditions contained in the Commission staff's prior no-action letters allowing householding of shareholder reports, and there is no sound policy reason to change this requirement in Rule 154.10 Moreover, proposed Rule 154's notice provisions impose enormous costs on mutual funds due to the requirement of separate mailings without providing corresponding benefits.

Third, there should be no notice or consent requirements in order to household prospectuses for multiple accounts held by the same individual. For example, if an individual holds shares in the same mutual fund through his or her taxable securities account, individual retirement account and a minor's account for which he or she serves as custodian, there is no reason why more than one prospectus needs to be sent to that individual. Thus, Rule 154 should confirm that a mutual fund may mail a single prospectus to an individual who holds shares of a mutual fund through multiple accounts without providing any notice or obtaining the shareholder's consent.

## Delivery Requirements

Under proposed Rule 154, a prospectus would be deemed delivered if the person relying on the rule delivers the prospectus to a natural person who shares the address and the other persons consent to delivery of a single prospectus. The rule would not require that a prospectus be delivered to an investor at the address that is shared with the other investors. The Commission has requested comment on whether the rule should require that the prospectus be delivered to the investors' shared address.

Allowing mutual funds (or their designees) to send prospectuses to an address of an investor other than the shared address would authorize more delivery options. However, sending prospectuses to an address other than the shared address would not be in the best interest of investors. For example, sending the prospectus to a non-shared address may raise issues as to whether the investors that do not share the address will have access to that prospectus. Accordingly, the rule should require that a householded prospectus be delivered to the investors' shared address, unless the person subject to the rule permits householded investors to request that documents be sent to some other address, and such a request is made.

Proposed Rule 154 also would not require investors to specify the name of the investor who will receive the prospectus. However, it would require that the prospectus be addressed to a natural person and would prohibit addressing a prospectus to a group of persons (e.g., "The Smith Household"). The Proposing Release states that the Commission is concerned that addressing prospectuses to a group will reduce the likelihood that the prospectus envelope will be opened and read (based on the belief that the person reading the envelope will regard it as "junk mail").11 The Commission has requested comment on

whether the rule should require investors to specify the name of the investor who will receive the prospectus, and whether there should be restrictions on who can receive a prospectus (e.g., adults only). The Commission also has requested comment on whether the rule should allow addressing prospectuses to a group of persons.

We agree that the rule should provide flexibility as to whom a prospectus may be addressed. As the Commission notes, if investors are required to specify who will receive the prospectus for their household, then investors would be required to designate a new recipient each time the previously designated recipient no longer shares that address. This requirement would hinder the ability of mutual funds to household due to the record-keeping costs and complications that it would create, and could inconvenience investors, who would have to designate a new recipient each time the previously designated recipient no longer shared the address. Additionally, computer systems often are capable of linking fund accounts by shared address to assist in determining which accounts to household without requiring a designated recipient for the household. Thus, there is no need for investors to specify who will receive the prospectus.

Along the same reasoning, the rule should not require that prospectuses be addressed to a single natural person or otherwise prohibit mutual funds (or their designees) from addressing prospectuses to a group of persons, such as "The Smith Household" or "John Jones and Jane Doe." We disagree with the contention that addressing a prospectus to a group of persons reduces the likelihood that the envelope will be opened because it is "junk mail." In fact, vast amounts of "junk mail" are addressed to natural persons rather than to groups or households, and personal mail frequently is addressed to a household or family group. Moreover, addressing a prospectus to a group increases the number of persons to whom the envelope is addressed, thus also possibly increasing the likelihood that someone in the group will open it and read the contents.[12]

Additionally, the Commission staff no-action letters that have permitted householding of shareholder reports do not require addressing such reports to a single natural person.[13] Accordingly, the rule as proposed would require mutual funds that currently rely on these no-action letters to cease sending householded reports to any addressee that does not fit this description. There is no need to make this burdensome and unnecessary change.

The proposal also should be clarified to expressly permit householding where a corporate entity (such as a bank or broker-dealer) has been named as trustee for an individual retirement account or similar retirement account arrangement. Thus, for example, householded documents presumably may be sent to an individual who holds an IRA for which a bank has been appointed trustee. Similarly, securities accounts held by an entity that shares an address with natural persons (such as a family-owned business that is run out of an investor’s home) should be permitted to be householded with accounts held by natural persons. While we assume that this was the Commission’s intent, the rule (or release adopting the rule) should clarify that such accounts are included within its coverage.

There is no need to restrict who may receive a prospectus, such as restricting delivery to adults only. In almost all cases, a mutual fund account is held by an adult natural person, an entity (such as a corporation, partnership or trust) with an adult officer, director, partner, employee, trustee or other designated individual who receives correspondence on behalf of the account, or a custodial account for the benefit of a child or other beneficiary with an adult custodian. Thus, the concern that a prospectus could be sent to a child or other legally incompetent person generally will not arise. In any event, as a legal matter, if an

individual is a shareholder in a mutual fund, he or she is entitled to receive correspondence related to his or her shares.

The Commission also has requested comment on how the rule should govern documents that are delivered electronically. As discussed above, we believe that prospectuses generally should be delivered only to the shared address of the householded investors. Thus, the issue of sending a single copy of the prospectus or other document electronically should not arise unless the householded investors share an electronic address or specifically request electronic delivery to some other address. If a prospectus were sent to the electronic address of only one of the householded investors, this would raise issues of whether the other investors would have access to the document, particularly if they did not have access to the recipient's electronic mailbox. If householded investors do share an electronic address (or otherwise request electronic delivery), then delivery of the prospectus should be in accordance with the Commission's 1995 and 1996 releases on electronic delivery of documents.14

## Scope of Rule 154

Under proposed Rule 154, a prospectus would be deemed delivered for purposes of Sections 5(b) and 2(a)(10) of the Securities Act to all investors who share an address, provided certain conditions are met. The proposed rule would be available for all persons who have prospectus delivery obligations under the Securities Act, except when a prospectus is required to be delivered in connection with a business combination transaction, exchange offer or reclassification of securities, since these types of prospectuses generally are accompanied by proxies or tender offer materials that must be executed by each individual investor.

The Commission has requested comment on whether companies should be permitted to rely on the rule for delivery of these types of prospectuses. While it may be appropriate in the future to expand Rule 154's scope to cover prospectuses delivered in connection with business combination transactions, exchange offers or reclassifications of securities, it is not necessary for Rule 154 to cover these types of prospectuses upon its adoption. Because proxy votes can involve more complicated consent issues, it may be best to postpone including these types of prospectuses within Rule 154's coverage until the householding of prospectuses has become a more established practice.

On a different but related matter, we seek clarification that proposed Rule 154 would extend to the delivery of prospectus supplements, as well as prospectuses themselves. While it appears that the delivery of prospectus supplements is within the scope of the proposed rule, and there is no logical reason for them not to be included, clarification would eliminate any potential confusion about this issue.15

## Resumption of Delivery of Prospectuses

The proposed rule would require that, if an investor requests resumption of delivery of prospectuses, the person relying on the rule must resume individual delivery of future documents after 30 days. We believe that this time period for resuming delivery is appropriate.

Delivery of Shareholder Reports to a Household
As discussed above, the Commission is proposing to amend Rules 30d-1 and 30d-2 under

the Investment Company Act to permit investment companies to deliver one shareholder report per household under substantially the same conditions as under proposed Rule 154. The Commission has requested comment on whether the conditions for householding shareholder reports should be the same as those for householding prospectuses. There is no reason to not impose the same conditions for delivery of shareholder reports and prospectuses. To do otherwise would result in different regulatory regimes depending on the document being householded, which would increase costs and complicate matters unnecessarily, particularly since prospectuses and shareholder reports often are delivered in the same envelope.

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We appreciate the opportunity to comment on the Proposing Release. If you have any questions about these matters, please do not hesitate to call me at (202) 326-5819.

Sincerely,

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**ENDNOTES**

1 The Investment Company Institute is the national association of the American investment company industry. Its membership includes 6,742 open-end investment companies ("mutual funds"), 442 closed-end investment companies, and 10 sponsors of unit investment trusts. Its mutual fund members have assets of about $4.359 trillion, accounting for approximately 95% of total industry assets, and have over 62 million individual shareholders.

2 SEC Release Nos. 33-7475, 34-39321 and IC-22884 (Nov. 13, 1997), 62 Fed. Reg. 61933 (Nov. 20, 1997) (the "Proposing Release"). Specifically, in addition to proposing Rule 154

under the Securities Act, the Commission has proposed to amend Rules 14a-3 and 14c-3 under the Exchange Act and Rules 30d-1 and 30d-2 under the Investment Company Act.

3 Proposing Release at 1.

4 15 U.S.C. §§ 77b(a)(10), 77d(1), 77e(b).

5 See Oppenheimer Management Corporation, SEC No-Action Letter (July 20, 1994); Scudder Group of Funds, SEC No-Action Letter (June 19, 1990).

6 In some cases, broker-dealers that sell mutual funds employ intermediaries, such as large mail houses, to deliver prospectuses and shareholder reports to investors. We are aware of problems that have arisen with such intermediaries in connection with householding mutual fund shareholder reports. In the release adopting the final rules, the Commission should encourage broker-dealers and intermediaries to cooperate with mutual funds that wish to household documents in order to ensure that these objectives are in fact realized.

7 Rule 154 should, however, allow persons relying on the rule to obtain the written consent of investors to householding in the customer agreement as an alternative to providing notice in the prospectus.

8 Where mutual fund shares are sold through broker-dealers, even where the broker-dealers are responsible for sending prospectuses and shareholder reports to investors, as a matter of practice, the cost of sending such documents to investors is borne by the mutual funds (and ultimately, the investors) themselves. Broker-dealers have little, if any, incentive to include householding consent provisions in their customer agreements.

9 Although under proposed Rule 154 a notice procedure could be used in lieu of written consent for investors that have "established an account" prior to the effective date of the rule, this procedure would not be available with respect to investors that establish new accounts after the effective date of the rule. Many mutual funds establish a new account for each new fund purchased, and thus the notice procedure would not be available for these funds if their shares were acquired through an exchange after the effective date of the rule. In addition, the proposed amendments to Rules 30d-1 and 30d-2 would allow a notice procedure only for investors that first purchased shares of a fund before the effective date of the rule. Thus, this procedure would not be available under Rules 30d-1 and 30d-2 for shares of a new fund acquired through an exchange after the effective date of the rule even if a new account were not established.

10 See, e.g., Oppenheimer Management Corporation, SEC No-Action Letter (June 20, 1994). We assume that mutual fund companies that are already householding documents in reliance on the Oppenheimer and Scudder no-action letters (see supra note 5) will not be required under the final rules to renotify or otherwise obtain the written consent of investors who are already receiving householded documents. This should be made clear in the final rules or the adopting release that accompanies the final rules.

11 Proposing Release at 9-10.

12 For example, if a prospectus envelope is addressed to several named individuals, it seems more likely that one of the named individuals would open and read the prospectus than if the envelope were addressed to only one of the named individuals.

13 See Oppenheimer Management Corporation, SEC No-Action Letter (June 20, 1994).

14 See Securities Act Release No. 7233 (Oct. 6, 1995) (60 Fed. Reg. 53458 (Oct. 13, 1995)); Securities Act Release No. 7288 (May 9, 1996) (61 Fed. Reg. 24644 (May 15, 1996)).

15 In most cases, separate delivery of mutual fund prospectus supplements to investors is not be required under the federal securities laws; however, in cases where prospectus supplements are delivered to investors, they should be covered under the rule.

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