

October 30, 2018

Mr. Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: Request for Comment on Fund Retail Investor Experience and Disclosure; File No. S7-12-18

Dear Mr. Fields:

The Independent Directors Council¹ appreciates the opportunity to provide comments on enhancing disclosures by mutual funds, exchange-traded funds, and closed-end funds to improve the investor experience and to help investors make more informed investment decisions, in response to the Commission's request for comments.² Fund directors, who serve to protect the interests of fund shareholders, support providing investors with useful, accessible, and clear information. We commend the Commission for considering advancements in technology and other developments in evaluating ways to improve the investor's experience in reviewing, buying and selling funds.

The Release includes a number of questions relating to the delivery, design, and content of fund disclosures. IDC's comments focus on the questions relating to those topics that are of particular interest to fund directors. In general, IDC supports efforts to modernize disclosure requirements that help investors to focus on and understand key information about their funds and that also reduce costs to funds, which are ultimately borne by shareholders.

¹ IDC serves the US-registered fund independent director community by advancing the education, communication, and policy positions of fund independent directors, and promoting public understanding of their role. IDC's activities are led by a Governing Council of independent directors of Investment Company Institute member funds. ICI is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds, closed-end funds, and unit investment trusts in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI's members manage total assets of US\$22.7 trillion in the United States, serving more than 100 million US shareholders, and US\$7.3 trillion in assets in other jurisdictions. There are approximately 1,700 independent directors of ICI-member funds. The views expressed by IDC in this letter do not purport to reflect the views of all fund independent directors.

² *Request for Comment on Fund Retail Investor Experience and Disclosure*, SEC Release Nos. 33-10503; 34-83376; and IC-33113 (June 5, 2018) ("Release"), available at <https://www.sec.gov/rules/other/2018/33-10503.pdf>.

Delivery of Fund Information

IDC supports promoting greater use of electronic-based disclosure of fund information, while giving investors the option to receive the information by mail if they so choose. Investors are increasingly living in an online world,³ and we believe that electronic-based disclosure is the way that most investors prefer to receive fund information.

The benefits of electronic delivery or online access of fund information include the potential cost savings for funds and their shareholders. The cost savings would be shared by all of the fund's shareholders—both those who access fund information online, as well as those who elect to receive information through the mail. Fund directors oversee fund expenses and are very cognizant of the effect that expenses have on a fund's performance and its returns to shareholders.

In addition, online fund information can enhance investors' access to fund information and, in doing so, facilitate investors' engagement and understanding. For example, research in the defined contribution retirement plan context indicates that the interactivity of electronic delivery has contributed to increased savings rates and that participants are more likely to act in response to materials provided electronically.⁴

The approach taken in rule 30e-3 under the Investment Company Act of 1940 ("1940 Act") for the delivery of shareholder reports adheres to these principles and should serve as a model for other disclosure requirements—in particular, the delivery requirement for summary and full prospectuses. Rule 30e-3 provides an optional "notice and access" method to allow funds to satisfy their obligation to deliver shareholder reports by making those reports available online free of charge (subject to certain conditions). Shareholders can still opt to receive shareholder reports through the mail and, thus, their choice for delivery will be honored. We strongly urge the Commission to establish through rulemaking a similar approach for modernizing prospectus delivery. As with the delivery of shareholder reports, a notice and access approach to prospectus delivery would reduce costs and be consistent with investors' preferences for accessing financial information online. Moreover, investors could still receive full and/or summary prospectuses by mail if that is their choice.

Design of Fund Disclosures

IDC agrees with the Commission that investors benefit from clear and accurate summaries of key information and, thus, supports greater use of summary disclosures. We believe that a layered disclosure approach, which provides summary information while also providing investors with the

³ Indeed, 95 percent of US households owning mutual funds identify themselves as having internet access. *See* Letter from Susan Olson, General Counsel, ICI, to Brent J. Fields, Secretary, SEC (October 31, 2018) ("ICI Letter"), available at https://www.ici.org/pdf/18_ici_sec_shareholder_ltr.pdf, at 26.

⁴ *Id.*

ability to access more detailed information, works well for investors and gives them the ability to access the level of detail they prefer.

This approach was successfully adopted in the context of mutual fund prospectuses. Nearly ten years ago, the Commission permitted mutual funds to deliver a summary prospectus, rather than the full prospectus, subject to certain conditions. The summary prospectus contains key information about the fund that is also contained in the summary section of the prospectus. A mutual fund that uses a summary prospectus must provide its prospectus, statement of additional information and recent shareholder reports on a website and deliver these documents by paper or email upon an investor's request.

This model should be extended to the delivery of fund shareholder reports and to prospectuses for variable insurance products. With respect to shareholder reports, funds should be permitted to deliver a summary shareholder report that includes certain key information, such as performance highlights, total return, expenses, and portfolio holdings, and in a specific order to facilitate the ability of investors to compare funds. Like the approach taken for prospectuses, shareholders should still be able to receive a full-length shareholder report upon request.⁵ ICI has developed a prototype for a summary shareholder report that the Commission should consider for future rulemaking in this area.⁶ We note that the Commission has included consideration of improved disclosure concerning variable annuities on its Regulatory Flexibility Agenda.⁷

We also strongly support encouraging the use of plain English in fund disclosure documents to facilitate investor understanding. In this regard, the Commission should eliminate requirements that funds use technical terms, such as "Rule 12b-1 fees," and allow funds the flexibility to provide information in a clearer manner for investors.

⁵ Also, under rule 30e-3 under the 1940 Act, funds would have the option to send shareholders a notice to satisfy their obligation to transmit shareholder reports by, among other things, making such reports and other materials accessible on the internet.

⁶ See ICI Letter, *supra* n. 3, at 6-24. ICI tested the prototype with more than a thousand mutual fund shareholders. More than 90 percent of these mutual fund investors agreed the prototype summary shareholder report was enough to stay informed, was a document they would be more likely to read, and that the more concise document made it easier to compare funds.

⁷ See Release, *supra* n. 2, at n. 47 (citing the Spring 2018 Regulatory Flexibility Act agenda); see also Dalia Blass, Director, Division of Investment Management, Testimony on Oversight of the SEC's Division of Investment Management (September 26, 2018), available at <https://www.sec.gov/news/testimony/testimony-2018-09-26-blass> (stating that the division is considering whether to recommend a new summary prospectus that would help investors better understand these products' costs and risks, and also produce cost savings that could be passed on to investors).

Content of Fund Disclosures

With respect to the content of fund disclosures, the Commission raises questions concerning the disclosure of risks, fees and expenses, and performance, among other topics. These are all important topics for investors, and we support clear and useful disclosures relating to them. These topics also can be complex, however, and it is important that any required disclosures not mislead or confuse investors. In addition, the Commission should avoid requiring disclosure of information simply because it could be made available through technological or other advances. While in some instances, certain new disclosures may at first blush appear helpful, the disclosures may not be significantly beneficial for investors and could, in fact, be quite costly and burdensome to funds.⁸ Thus, it is also important that the potential costs to funds (and their shareholders) of any new requirements be weighed against the potential benefits.

Regarding risk disclosures, the Commission observes that there are significant variations in funds' approaches to principal risk disclosures, including the length of those disclosures, and seeks input on ways to improve the framework for disclosing risks. Given the wide range of funds and their investment strategies, it is not surprising that there are variations in risk disclosures. One of the questions raised in the Release is whether a standardized risk measure or risk rating would be useful.⁹ We do not believe that there is a viable standardized risk measure that could be used for all funds. Because investment risk is multi-faceted, different concepts of risk cannot be captured in a single risk measure. The Commission considered this idea previously, in a 1995 concept release exploring ways to enhance mutual fund risk disclosure.¹⁰ The Commission aptly concluded not to require a fund to disclose information designed to quantify its expected risk levels, citing, among other things, the lack of a broad consensus as to what measure of risk would best serve fund investors.¹¹ That lack of broad consensus persists today. For these reasons, we also would not support singling out one type of quantitative risk measure—such as standard deviation or Sharpe ratio—as a required disclosure item.

Regarding disclosure of fees and expenses, the Commission raises questions about possibly requiring funds to provide investors with the actual fee and expenses associated with their investments

⁸ IDC made similar points in its comment letter on the proposed ETF rule with respect to the proposed disclosure of bid-ask spread information in a fund's prospectus. See Letter from Amy B.R. Lancellotta, Managing Director, IDC, to Brent J. Fields, Secretary, SEC (September 27, 2018), available at <https://www.idc.org/pdf/31415a.pdf>.

⁹ See Release, *supra* n. 2, at 42.

¹⁰ See *Improving Descriptions of Risk by Mutual Funds and Other Investment Companies*, SEC Release Nos. 33-7153; 34-35546; IC-20974 (March 29, 1995).

¹¹ See *Registration Form Used by Open-End Management Companies*, SEC Release Nos. 33-7512; 34-39748; IC-23064 (March 13, 1998).

and to require additional disclosures about a fund's soft dollars payments.¹² Providing customized fee and expense information would be logistically challenging inasmuch as funds do not maintain this type of information. To provide mutual fund investors with personalized cost information, fund transfer agents and intermediaries would have to build recordkeeping systems that track, calculate and store the fee information on a daily basis. Such an undertaking would undoubtedly be very costly to funds—and unnecessarily so. Each individual's buying and selling experience is unique, and intermediaries, rather than funds, generally have the customer-specific information.¹³

We believe that the better approach is similar to one part of the disclosure the Commission proposed in connection with the proposed ETF rule—to require funds to include narrative disclosure in prospectuses that investors may be subject to other fees not reflected in the fees and expenses table, such as brokerage commissions and fees to financial intermediaries.¹⁴ In addition, investors might be encouraged to use a standard online tool, such as the Commission's mutual fund cost calculator or FINRA's Fund Analyzer, to help them evaluate their costs.

The Commission also asks what disclosure, if any, funds should provide about soft dollars (the portion of transaction costs that pays for research provided by third-party broker-dealers that is used by the adviser to make investment decisions). While IDC supports disclosure of useful and relevant cost information to fund investors, we do not believe that additional soft dollar disclosures are warranted. A fund's registration statement already contains disclosure regarding brokerage practices, including the use of soft dollars.¹⁵ We question the value to investors of additional disclosures, which could be complicated if not provided in the proper context. The current disclosure requirements, combined with board oversight of portfolio trading, which includes evaluation of soft dollar arrangements and potential conflicts of interest, provide appropriate investor protections.

The Commission asks a number of questions pertaining to disclosure of fund performance. One question is whether a fund should include in its prospectus a comparison of its performance or fees

¹² See Release, *supra* n. 2, at 45 and 47. Fund investors already have significant cost information available to them. About nine in 10 mutual fund-owning households review the fund's fees and expenses when choosing a mutual fund. Moreover, likely reflecting their emphasis on reviewing mutual fund fees, mutual fund investors tend to concentrate their assets in lower-cost funds. See ICI Research Perspective, *What US Households Consider When They Select Mutual Funds* (August 2018), available at <https://www.ici.org/pdf/per24-05.pdf> at 8-9.

¹³ Most shareholders invest in funds through a financial intermediary. See ICI Research Perspective, *Characteristics of Mutual Fund Investors, 2017* (October 2017), available at <https://www.ici.org/pdf/per23-08.pdf>, at 10 ("Among households owning mutual funds outside of employer-sponsored retirement plans, 79 percent owned funds purchased from an investment professional.")

¹⁴ See *Exchange-Traded Funds*, SEC Release No. IC-33140 (June 28, 2018) at 152-53 (describing proposed amendments to Item 3, Form N-1A under the 1940 Act).

¹⁵ See Item 21, Form N-1A and Item 22, Form N-2 under the 1940 Act.

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with that of a peer group of funds.¹⁶ We do not support requiring this type of disclosure. Although some funds may voluntarily provide some comparison information on their website or through other communications, it should not be required prospectus disclosure. Because each fund has its own investment strategy and portfolio structure, the selection of an appropriate peer group is not always straightforward and could be subject to cherry picking. Moreover, there can be a variety of reasons for why a fund may compare favorably or unfavorably to a peer group, which would not be easy to explain in a prospectus. In addition, third-party vendors already track and aggregate data on thousands of funds and make the data available for public consumption.

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If you have any questions about our comments, please contact Annette Capretta, Deputy Managing Director, at (202) 371-5436 or me at (202) 326-5824.

Sincerely,



Amy B.R. Lancellotta
Managing Director

cc: The Honorable Jay Clayton
The Honorable Kara M. Stein
The Honorable Robert J. Jackson Jr.
The Honorable Hester M. Peirce
The Honorable Elad L. Roisman

Dalia Blass, Director
Division of Investment Management

¹⁶ See Release, *supra* n. 2, at 46 and 50.