

Speech

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Introduction

Good morning. Thank you Susan [Olson], and thank you, all, for the opportunity to join you today.^[1]

Since I spoke with you last year, the Division has been busy on many fronts. This morning, I am going to focus on three of these: first, fund disclosure; second, fund use of derivatives; and third, staff guidance, which I know is on many of your minds. You also will hear from my colleagues about many other projects later today. Paul Cellupica, our Deputy Director and Chief Counsel, will join the Regulatory Developments panel this morning. Then Melissa Gainor, Sara Cortes and Michael Kosoff will participate in the discussions of ETFs, standards of conduct and fund disclosure.

We are covering a broad range of topics today, and they represent only a part of the Division's work. With so much going on, you may be wondering, what it is that ties our work together? What are the common themes? As we think about where to focus our efforts, we are actually following a pretty simple set of principles. First, we want to improve the investor experience. Second, we need to modernize key areas of our regulatory framework. And, third, we seek to leverage our resources efficiently. I see these principles as key to ensuring that we serve investors in the best way possible. In addition to these principles, running throughout our work is a strong belief that outcomes improve with understanding. That means our approach to each project starts with engagement – with investors, with Commissioners, with lawmakers, with industry participants, with investor advocates and with anyone else who would like to share their views and experiences. As my colleagues and I talk about our work today, I would like you (and anyone who reads this speech) to view it as an invitation to come tell us about your experience and ideas. We value and use that input.

With that, I am going to turn to the first topic of the day, fund disclosure. But first, let me remind you that I am speaking today only for myself and not for the Commission, the Commissioners or the staff.^[2]

The Investor Experience Initiative: Start by Improving Fund Disclosure

Last year, the Division launched a new initiative to take a fresh look at the investor experience. Through this initiative, we are seeking opportunities to improve the quality and usefulness of information that investors receive about funds and advisers. Our approach differs from other recent work on fund disclosure because we are focusing on how information serves investors, not on how the Commission uses information.

We are approaching this initiative from many directions. Naturally, we started with investors. We are making every effort to connect directly with individuals and also to bring their views into the comment process. We have visited with members from local chapters of a national investment group. We have met service members who were planning for retirement. We have joined the Chairman and Commissioners at investor roundtables. And we have developed new and simpler ways for investors to provide feedback on the proposals that directly affect them. These include a “feedback flier” that allows investors to submit comments without needing to review the entire rulemaking proposal or write a letter, and the new “Tell Us” website, which provides a portal for this feedback. So far, we have received 140 comments using the new fliers. We will continue this engagement in 2019, and I would welcome suggestions from asset managers who have experience reaching out to investors for feedback.

We have also seen glimpses of the future. Several asset managers have given us demonstrations of their latest investor-facing technology and shared thoughts on what may come next. I believe that asset managers, data aggregators and others have the potential to develop tools that layer, enrich, connect and analyze disclosure in ways that meet investors where they are. The key question for us in the Division is whether changes in rules or forms would help unlock these opportunities for investors. In 2019, I would like to continue hearing from asset managers and others about where they see the future of disclosure content, design and delivery and whether there are regulatory barriers to deploying technology. How do we write the rules of the future so you can provide the disclosure of the future?

In addition to our informal outreach, we have worked with the Commission to take several concrete rulemaking steps. Growing most directly out of the Investor Experience Initiative, the Commission issued a request for comment in June seeking feedback on improving the content, design and delivery of fund disclosure.^[3] We requested feedback by the end of October. We hope to hear from a diverse group of commenters, including those who do not often comment on our rulemakings, like literacy and design experts. These responses will be important to determining where we go next.

Over the last year, the Commission also adopted rule 30e-3, issued a request for comment on the framework for fees that intermediaries charge to deliver disclosure documents and proposed a short-form summary to explain the terms of an investor’s relationship with a broker-dealer or investment adviser.^[4] We are also hoping, in the near future, to present the Commission with a recommendation to propose a summary prospectus for variable insurance products.

This is an exciting start. However, I will offer two observations about where we are: first, although these initial steps all aim to improve the investor experience, they span a wide range of topics; and second, looking beyond these steps, there are still many opportunities to improve the investor experience. The simple truth is that no single form, statement or rule is going to finish the work of modernizing the content, design and delivery of disclosure. In fact, I do not believe Commission action can get there on its own.

We support innovation, but we are not the innovators. We promote clear disclosure, but we do not write the documents. We oversee a framework, but we are not part of the investment relationship. At the end of the day, asset managers, their counsels, data aggregators and other service providers play a central role in the investor experience. I encourage them, and each of you, to think not just about what the Commission should do to improve it but also about what steps you can take today.

To help get you started, here are a few thoughts that I invite you to consider:

First, when it comes to fund disclosure, tell a clear story.

A fund's prospectus and summary prospectus should tell the story of the fund. They should provide a reliable roadmap of the fund's strategies and key risks. However, we regularly see disclosure in which length trumps clarity and the story is buried.

The poster child is alphabetized risk disclosure. This feels like an old conversation, but review staff still see funds that present their key risks in alphabetical order. For example, we have seen more than one fund investing primarily in real estate that identifies real estate investment risk down with the "Rs." This may be four, or even fourteen, risk factors from the top. I strongly suspect that the actual importance of risks rarely, if ever, coincides with the alphabetical order of those risks. If I am right, then what we are seeing is disclosure that makes investors work hard to identify what the fund already knows and should tell them.

Another area for improvement is generic risk disclosure. We have seen fund families using standardized, generic risk disclosures that they have not tailored to a particular fund. I will give you a real example, though it is by no means the only one. A fund invests *almost entirely* in common stock. It *may* use derivatives, but actually holds only a small amount of derivatives. When you look at the fund's summary prospectus, however, the derivatives risk disclosure is more than three times the length of the equity risk disclosures. And the derivatives risk disclosure appears first. The derivatives risk disclosure may be nicely written, clear and balanced, but if the fund is not really using derivatives, it is probably not telling the investor the right story.

Another example is disclosure for "go anywhere funds." These funds retain the ability to invest in several asset classes or types of securities. In practice, however, some of these funds actually invest in only one or a few of those asset classes or types of securities. This is an opportunity to revisit the disclosure year to year and check whether it continues to match what the fund is actually doing. Certainly, an investor should know that the fund has broad flexibility to change its approach, but the fund's story is only clear if it distinguishes the possible from the actual.

Second, write clearly and concisely.

Let's be honest, lawyers are not masters of the plain-spoken. We excel at careful writing and detail, but not simplicity and clarity. I think that may account for some of what we see in fund

disclosures. Here are some examples that concern me:

- Mutual fund summary prospectuses that are much longer than the brief documents the Commission intended;^[5]
- Individual sentences that contain over 70 words;
- Explanations of tracking error with more than 1,000 words;
- “Summary” risk disclosure that is identical to the full-scale risk disclosure in the statutory prospectus; and
- Passages so full of jargon that even our staff – who review fund disclosures for a living – pull out the reference guides.

I know we can do better. We all know that individuals and households are participating in the capital markets more than ever through funds. That means your audience includes: a 25 year old making his first contribution to a retirement account; a retiree shifting her portfolio to preserve capital; a financial planner who has spent a career learning about investments; and a programmer who can code in her sleep but has never thought about investing before. As diverse as these folks are, I am confident that they share at least one thing in common – they are more likely to read and understand fund disclosure if it doesn’t require an afternoon and a dictionary.

For our part, staff in our disclosure office will do their best to help you identify writing that has grown too complicated, summaries that don’t summarize and jargon that doesn’t clarify. I encourage you to do what you can – and not wait for rulemaking – to start improving the investor experience.

During conversations with asset managers, boards and practitioners, I have heard more than once that concerns about legal liability, in part, drive the jargon, complexity and length of fund disclosures. I find this line of thinking a bit confusing. The primary purpose of the disclosure requirements under the federal securities laws is to provide investors with information to make an informed investment decision. Informing investors through clear, accessible writing and providing disclosure that meets the legal standard are not mutually exclusive goals. For example, I would encourage you to think about how layered disclosure can help achieve both these goals by allowing funds to provide a roadmap and additional detail. Improving the quality and usefulness of fund disclosure for the benefit of Main Street investors is a goal we should all be able to get behind.

Finally, engage with disclosure staff.

The last point I will make before I move off the topic of disclosure is that we want to work with you. Over the last year, I have seen great engagement from you and many others on our rulemaking agenda. I would like to see the same kind of policy-level engagement on disclosure. Where do fund sponsors see opportunities for disclosure to better serve Main St. investors, and how can we help? What do fund sponsors think is working or not in the review process? When you had a question about a comment received from the review office, did you set up a call or meeting with staff to discuss and understand the reason for the comments? Have you taken the time to explain to your staff reviewer the key drivers for the fund?

I also invite you to engage with staff on fund-specific questions. If you have a fund filing that is straight-forward and merits a selective review approach, tell us. You can put it in your cover letter. We read them, and we, like you, want our disclosure review process to be efficient,

targeted and effective.^[6] On the other hand, if you have an idea for a novel fund, consider talking with us before you file. In many cases, I think you will find that taking the time for an initial dialogue will ultimately be the most efficient approach.

At the same time, we are trying, from our end, to add greater transparency to our review process. Earlier this year, we re-launched the Division's disclosure website and posted several Accounting and Disclosure Information notes. These are part of a Division effort to better explain the goals and mechanics of our review process.^[7] We are planning to continue adding information that may be helpful to filers and investors. If you have a question that you do not see answered there, let us know.

Derivatives Rulemaking

Switching gears, I want to talk about funds and derivatives. Here is the short background: We can, at least in my view, do better than the current guidance. The Commission most recently started a conversation in 2015, but many commenters were concerned about parts of that proposal. We (as a staff) have heard this feedback and have started with a fresh look. We have spoken with many fund sponsors, and we welcome input from more. We are working toward a recommendation for a re-proposal, but we have not, at this point, settled on an approach.

With that background, I would like to share a few of the questions with which we are grappling. First, how should we think about leverage risk in a dynamic market? The 1940 Act limits a fund's ability to incur leverage through senior securities.^[8] At the same time, products and practices develop continually, and the use of derivatives varies widely across funds. How can we honor the policy of the 1940 Act while providing sufficient flexibility? Is there an approach that provides meaningful boundaries for the use of derivatives while recognizing the diversity of funds and the benefits derivatives can provide when used responsibly?

What role should risk management play? Should a rule specifically recognize that risk management and related risk metrics are or should be conceived of holistically across interrelated areas, like liquidity and leverage? What role should asset segregation play? Asset segregation has been a feature of the landscape since 1979, but practices have varied significantly. What are funds doing today? Are additional, risk-based buffers common? What role should these practices play in a rule?

If any sponsors, scholars, risk managers or others have not yet come to share their thoughts, we welcome them. If you have shared your thoughts but have more, we welcome those too. So far, the staff has learned the most from simply hearing risk managers talk about current practice, but we are also open to creative and thoughtful ideas.

Staff Guidance

Before wrapping up, I want to address a topic about which I know many of you have questions – staff guidance. Last month, the Chairman issued a statement about staff views.^[9] In the statement, the Chairman explained that all staff statements are nonbinding on the Commission and create no enforceable legal rights or obligations of the Commission or other parties.^[10] The Chairman also noted that the Division has been and will continue to review whether prior staff statements should be modified, rescinded or supplemented in light of market or other

developments. As part of our review of prior statements, the Division also withdrew two staff letters issued in 2004 to proxy advisory firms.^[11] Since then, many of you have asked the staff what this means and what to expect next.

Regarding what this means, I believe the Chairman's statement reaffirmed what we all knew already. Statements of the staff are not statements of the Commission, and they do not have the force of law. That is why I gave the disclaimer – which you have heard dozens of times – at the start of this speech and why you will hear it a few more times today when my colleagues join the panels.

Our next steps are to continue our review and assessment of prior staff statements. In practice, that means our Chief Counsel's office and our disclosure office are looking at staff statements, including letters and frequent comments, and thinking about whether we need to make any changes. To me, this is just good government – as with all the staff's work on modernizing our regulatory framework, we should never hesitate to look back as well as ahead. Our review is a priority for the Division, but it will not be completed in weeks or all at once. As we work, we invite input from anyone who is interested.

In the meantime, Division staff remain available to advise and assist, just as we always have. We will continue to issue FAQs, no-action letters and other guidance, as appropriate, and we will continue to respond to public inquiries. I see assisting the public as an important part of the staff's mission, and I look forward to continuing to discuss the questions you have.

Closing

I am going to close with a thank you to the staff of the Division. I only touched on a small slice of our work today. Over the last year, the incredible members of the staff have:

- reviewed thousands of fund filings and exemptive requests;
- issued letters addressing protection of seniors, risk retention for BDCs and board duties under affiliated transaction rules;
- reviewed fund board responsibilities generally;
- developed data analytic tools and conducted focused outreach on fund practices;
- worked on developing recommendations on advertising, valuation, ETFs, fund research, BDC and closed-end fund offering reform and liquidity disclosure; and
- engaged in dialogue with sponsors on crypto-asset funds.

That is an incredible amount for a small staff, and I greatly appreciate their enthusiasm and commitment as we work to tackle challenging projects that I believe will serve Main St. investors well.

Thank you again for the opportunity to be here today.

^[1] For their assistance in preparing these remarks, I would like to thank the many members of the Disclosure Review and Accounting Office who contributed their thoughts and time, including acting Associate Director Jennifer McHugh, as well as John Lee from the Rulemaking Office.

[2] The Securities and Exchange Commission (“SEC” or “Commission”) disclaims responsibility for any private publication or statement of any SEC employee or Commissioner. This speech expresses the author’s views and does not necessarily reflect those of the Commission, the Commissioners, or other members of the staff.

[3] See Request for Comment on Fund Retail Investor Experience and Disclosure, Release No. 33-10503 (June 5, 2018) [83 FR 26891 (June 11, 2018)], available at <https://www.sec.gov/rules/other/2018/33-10503.pdf>.

[4] See Optional Internet Availability of Investment Company Shareholder Reports, Release No. 33-10506 (June 5, 2018) [83 FR 29158 (June 22, 2018)], available at <https://www.sec.gov/rules/final/2018/33-10506.pdf>; Form CRS Relationship Summary, Release No. 34-83063 (April 18, 2018) [83 FR 21416 (May 9, 2018)], available at <https://www.sec.gov/rules/proposed/2018/34-83063.pdf>.

[5] See Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-end Management Investment Companies, Release 33-8998 (January 13, 2009) [74 FR 4546 (January 26, 2009)], available at <https://www.sec.gov/rules/final/2009/33-8998.pdf>, at page 14 (“Our intent is that this information will be presented succinctly, in three or four pages, at the front of the prospectus.”).

[6] See ADI 2018-06, Requests for Selective Review, available at <https://www.sec.gov/investment/adi-2018-06-requests-selective-review>.

[7] Available at <https://www.sec.gov/investment/fund-disclosure-at-a-glance>.

[8] See Section 18(f) of the Investment Company Act.

[9] See Chairman Jay Clayton, Statement Regarding SEC Staff Views, available at <https://www.sec.gov/news/public-statement/statement-clayton-091318>.

[10] In this context, “staff statements” may include written statements, compliance guides, letters, speeches, FAQs and responses to requests for assistance that the staff of the Division write or provide.

[11] See IM-INFO-2018-02, Statement Regarding Staff Proxy Advisory Letters, available at <https://www.sec.gov/divisions/investment/imannouncements/im-info-2018-02.pdf>.