Securities Regulation Daily Wrap Up, TOP STORY—SEC modernizes fund report delivery while seeking feedback on disclosure; separately proposes Volcker rule modifications, (Jun. 5, 2018)

Securities Regulation Daily Wrap Up

Click to open document in a browser

By Amy Leisinger, J.D.

The SEC has adopted seriatim a new rule and related amendments to provide certain registered investment companies with an optional notice and access method by which to transmit shareholder reports to investors. Under new Investment Company Act Rule 30e-3, funds may satisfy their shareholder-report delivery obligations by making their reports publicly accessible on a website for free and sending paper notices of the availability of the reports to investors by mail. Investors may request to receive full reports in paper at any time free of charge. In related releases, the Commission requests feedback on processing fees charged by intermediaries in delivering fund reports requests and seeks comment on additional means by which to improve fund disclosure and modernize the information collected. The SEC has provided a feedback form for individual investors to submit their comments on how to enhance the design, delivery, and content of fund disclosures (*Optional Internet Availability of Investment Company Shareholder Reports*, Release No. 33-10506, *Request for Comments on the Processing Fees Charged by Intermediaries for Distributing Materials Other Than Proxy Materials to Fund Investors*, Release No. 33-10505, and *Request for Comment on Fund Retail Investor Experience and Disclosure*, Release No. 33-10503, June 5, 2018).

"These actions are an important part of the Commission's effort to better serve Main Street investors in our ever changing marketplace," said SEC Chairman Jay Clayton.

By a 3-2 vote in an open meeting, the SEC also approved the issuance of a proposal to amend a rule relating to the prohibitions and restrictions on proprietary trading and certain interests in, and relationships with, hedge funds and private equity funds under the Volcker rule. As part of a collaborative effort with the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the CFTC, the changes are designed to make the Volcker rule work more efficiently and provide banking entities with greater certainty regarding what activities are prohibited.

Rule 30e-3, comment requests. With the adoption of Rule 30e-3, a fund may make its reports and other required materials publicly accessible online free of charge and mail only a paper notice of each report's availability to investors. Funds may continue to satisfy their delivery obligations by mailing reports in paper and delivering reports electronically to investors who have chosen this method but now may also choose to provide notice and website accessibility as a default delivery method, or use a combination of the approaches. To rely on Rule 30e-3, a fund must make the shareholder report and the most recent prior report, as well as quarterly holdings for the last fiscal year, accessible online and satisfy certain format and location conditions.

Investors preferring paper may request at any time to receive all future reports in paper or opt to receive particular paper reports on an ad-hoc basis. Each report notice must explain how to access the report and how to request paper copies.

Chairman Jay Clayton noted that Rule 30e-3 is an "important and positive step toward modernizing the delivery of fund disclosures" and that online availability can provide investors with research and navigational tools not available in connection with paper documents. With the requests for comment, the Commission hopes to be able to further improve the investor experience and more effectively meet the needs of 21st century investors, he said.

According to Commissioner Michael Piwowar, Rule 30e-3 "is long overdue" and will improve investor convenience while save almost $1.5 billion over the next decade (according to the SEC's Division of Economic and Risk Analysis). Commission Hester Peirce echoed these sentiments, calling the new rule "a ray of light… breaking through the clouds of [the] often ineffective, wasteful, paper-intensive disclosure scheme." Even broader efforts should be made to streamline disclosures and make them more accessible, she suggested.

Though ultimately supporting the adoption of Rule 30e-3 with changes from its previously proposed form, Commissioner Kara Stein questioned whether the change would create a hurdle for certain investors to get the information they need to make informed decisions. The process to elect paper delivery should be easy, she said. Further, she noted, content included in fund disclosures should helpful and simple to use, and, hopefully, the requests for comment will provide new ideas for more broadly improving the investment company disclosure regime.

Funds may begin to rely on Rule 30e-3 no earlier than January 1, 2021, and comments regarding improved disclosure and processing fees are due October 31, 2018.

Volcker rule. With regard to the proposal to amend the SEC's Volcker rule provision, Chairman Clayton noted that the proposal aims to reduce the burdens of compliance for small and mid-size banking entities and would tailor requirements to the amount of a firm's trading assets and liabilities, imposing the most stringent requirements on entities with the most trading activity. The proposed changes would also clarify that firms trading within appropriate internal risk limits are presumed to be engaged in permissible market making or underwriting activity and simplify the trading information that entities are required to provide. The proposal also seeks to improve the practical application of the market making, underwriting, and risk-mitigating hedging exemptions and gather input on whether and how the agencies should tailor the rule's definitions.

In opposition to the proposal, Commissioner Stein lamented that the proposed amendment appears to be designed to make it easier for banks to take on greater leverage and risk and that it could undo the framework that has helped avoid another financial crisis. The proposed amendment could pave the way for risky trading strategies by expanding the hedging-related exemptions and hinder competition between federally insured financial institutions and those without access to federal backing. The approach of "presumed compliance" for banks with limited trading assets significantly reduces accountability and could encourage evasion, she opined. "When it comes down to it, I believe that we should be preventing acceleration of risks, conflicts of interest, and concentration in our markets, not encouraging them," Stein stated.

In addition to criticizing the economic analysis underlying the proposal, Commissioner Robert Jackson echoed Stein's concerns, noting that the proposed changes could further blur the distinction between market-making activities and prohibited proprietary trading while enabling concealment of risky bets. "Rolling back the Volcker Rule while failing to address pay practices that allow bankers to profit from proprietary trading puts American investors, taxpayers, and markets at risk," he explained.

MainStory: TopStory AlternativeInvestmentFunds BrokerDealers DoddFrankAct FinancialIntermediaries HedgeFundsNews InvestmentCompanies PublicCompanyReportingDisclosure RiskManagement