



NASAA

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January 4, 2021

By email to: [rule-comments@sec.gov](mailto:rule-comments@sec.gov)

Vanessa Countryman  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

Re: **File Number S7-09-20: 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**

Dear Ms. Countryman:

On behalf of the North American Securities Administrators Association, Inc. (“NASAA”),<sup>1</sup> I am writing in response to U.S. Securities and Exchange Commission (“SEC” or the “Commission”) Release No. 33-10814, *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*, File No. S7-09-20 (the “Proposal”).<sup>2</sup> The Proposal would substantially improve the regulatory framework governing investment company disclosures and NASAA accordingly supports it and encourages its approval.

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<sup>1</sup> Organized in 1919, NASAA is the oldest international organization devoted to investor protection. NASAA’s membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, Puerto Rico, and the U.S. Virgin Islands. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

<sup>2</sup> The Proposal is available at <https://www.sec.gov/rules/proposed/2020/33-10814.pdf>.

## I. Introduction

The Proposal would overhaul how open-end management investment companies – *i.e.*, mutual funds and most exchange-traded funds (“ETFs”)<sup>3</sup> – communicate with investors. The Proposal would retain the basic disclosure framework that currently exists, with prospectuses and Statements of Additional Information (“SAIs”), annual and semi-annual shareholder reports, portfolio holding reports and investment company advertising, but it would reform these disclosures to target them to different audiences. As part of this layered disclosure framework, annual and semi-annual shareholder reports would become the primary disclosures for existing investors while prospectuses would be geared for prospective investors.

Among its other changes, the Proposal also would revise Form N-1A and its instructions to encourage more succinct and digestible disclosures. Shareholder reports would be shortened and made more user-friendly through the use of graphics. Prospectuses would be simplified by curbing verbose summary risk disclosures, replacing the existing fee table in the summary section of the statutory prospectus with a simplified fee summary, moving all non-principal risk disclosures into SAIs, and adjusting disclosures related to acquired fund fees and expenses. The Proposal would make conforming updates to the SEC’s relevant advertising rules as well. We support these initiatives and believe they would have very positive regulatory impacts. We offer specific comments below in response to certain questions raised in the Proposal.

## II. Responses to Specific Questions Raised in the Proposal

### A. Responses to Questions 1, 2, 4 and 126: The SEC Should Require Separate Shareholder Reports for Every Fund Series.<sup>4</sup>

NASAA recommends that funds be required to prepare separate annual and semi-annual shareholder reports for every fund or series thereof.<sup>5</sup> Many funds currently consolidate their shareholder reports for multiple series into a single document. These consolidated reports can run to hundreds of pages and contain information about potentially dozens of separate investment series. This may be easier for funds than creating separate reports, but it places an inordinate

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<sup>3</sup> See Proposal at 8, n.4. The Proposal would not apply to ETFs organized as unit investment trusts or other types of investment companies such as closed-end funds, including business development companies, or variable annuities. *Id.* at 61, 63.

<sup>4</sup> *Id.* at 54, Question 1 (“Would the proposed requirement that a fund registrant prepare separate annual reports for each of its series result in shareholder report disclosure that is easier for fund shareholders to navigate and assess? ....”); 54-55, Question 2 (“Are there certain types of funds for which a multi-series presentation in an annual report may be useful to shareholders? ....”); 55, Question 4 (“A fund may have multiple share classes with differing fee structures. Should these multi-class funds be permitted to reflect only one or a subset of classes, rather than all share classes in a shareholder report so long as a fund produces a shareholder report that relates to each share class?”); and 177, Question 126 (“... To the extent the Commission changes the proposed scope of annual reports, should the Commission adopt those same changes for semi-annual reports? ....”).

<sup>5</sup> See *id.* at 48-54.

burden on retail investors, who must ferret out information on their particular investments by searching the document for their specific series name or ticker symbol. Investors deserve to receive shareholder reports for their particular investments without being forced to wade through extraneous disclosures about other investment series.

Indeed, we can see no reason that retail investors would prefer to receive consolidated shareholder reports of all series in a fund instead of distinct reports for the specific series in which they are invested. The only potential benefits of consolidated reports would be to make it easier for investors to compare two or more series of a fund or to simplify disclosures for investors who have invested in multiple series of the same fund. But these potential benefits would not outweigh the considerable inconvenience for most retail investors caused by long and cumbersome consolidated reports. We believe this conclusion applies both to annual and semi-annual reports. Accordingly, we encourage the Commission to require funds to prepare separate shareholder reports for every investment series.

**B. Responses to Questions 49 through 53: The SEC Should Require Every Series to be Benchmarked to a “Broad-Based Securities Market Index,” Define Clear Standards for such Indexes (but Permit the Use of Secondary Indexes), and Apply these Standards to Shareholder Reports and Prospectuses.**<sup>6</sup>

NASAA supports requiring funds to benchmark the performance of every investment series against a “broad-based securities market index” as outlined in the Proposal.<sup>7</sup> The purpose of this benchmarking would be to ensure that investors have a simple, readily-accessible window into the performance of a specific investment fund against the broader performance of the securities markets. We believe additional strictures should be added, though, with respect to what qualifies as a “broad-based securities market index.”

The current Form N-1A instructions state a broad-based securities market index is “one that is administered by an organization that is not an affiliated person of the Fund, its investment

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<sup>6</sup> *Id.* at 101, Question 49 (“Should we require funds to provide information in shareholder reports about the performance of an appropriate broad-based securities market index, as proposed? ... If so, do these benefits justify the burdens, including costs to the fund (and ultimately its shareholders) of paying one or more index providers to allow the fund to include this information in the fund’s disclosure? ....”) and Question 50 (“Should we modify the definition of ‘appropriate broad-based securities market index,’ as proposed? ....”); 102-03, Question 51 (“Are there other changes we should make to the definition of appropriate broad-based securities market index, or to the framework for providing index performance more generally? ... [A]re there ways we could address concerns that some funds may choose an index for the purpose of making the fund’s performance look better? ....”); and 103, Question 52 (“We are proposing to amend the definition of appropriate broad-based securities market index for purposes of Form N-1A. Should the same amended definition apply to fund prospectuses and fund shareholder reports, as proposed? ....”) and Question 53 (“Should funds have discretion to provide information in shareholder reports about the performance of more narrowly based indexes that reflect the market sectors in which the fund invests, as proposed? ....”).

<sup>7</sup> *See id.* at 93-99.

adviser, or principal underwriter, unless the index is widely recognized and used.”<sup>8</sup> The Proposal would retain this open-ended standard, with the addition that the index should be “one that represents the overall applicable domestic or international equity or debt market, as appropriate.”<sup>9</sup>

Even with the addition of this clarifying language, NASAA is concerned that funds could select indexes based on subjective criteria with an eye toward portraying the fund’s performance in a distorted light. We believe the SEC should further define the characteristics of broad-based market indexes to ensure that the indexes eligible for selection rely on objective criteria. In this vein, we suggest that the SEC incorporate more specific criteria into the standards for broad-based market indexes, including that the index must adhere to an objective methodology for securities selection that is publicly disclosed by the index creator and that is verifiable and reproduceable with publicly available information.<sup>10</sup> Adding such a criterion would allow investors and regulators to scrutinize the index chosen to determine if it is indeed objective, broad-based, and not skewed in any way to appeal to certain funds.<sup>11</sup>

Although every fund series should be required to benchmark its performance against an appropriate broad-based securities market index, we agree that funds should continue to have the ability to benchmark their performance to more targeted indexes if the fund desires to do so. The most obvious examples are index funds that track particular segments of the securities market. These funds do not try to replicate the overall market, so a second benchmark targeted to their particular niche is appropriate and helpful to investors. Non-index funds, though, also may reasonably conclude that a second benchmark aids in assessing the fund’s performance. For

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<sup>8</sup> See Form N-1A at 61 (Instruction 5 to Item 27(b)(7)(ii)), available at <https://www.sec.gov/files/formn-1a.pdf>. We recognize that certain widely accepted and trusted indexes may not satisfy the definition of a “broad-based securities market index,” but that the acceptance of such indexes creates utility for investors seeking to compare a fund’s performance against a known measure. Therefore, we agree that this flexibility is acceptable for current widely accepted indexes and, indeed, could be useful for future indexes that become widely accepted but may not be in complete compliance with the definition as proposed and as would be in line with our comments. However, the value of bolstering the requirements for broad-based securities market indexes as we suggest, even in light of the existence of widely accepted but non-compliant indexes, is to create a uniform and robust standard against which indexes can be judged in order to avoid the proliferation of indexes that do not adequately capture the overall performance of applicable securities markets.

<sup>9</sup> See Proposal at 98 (describing additional proposed clarifying language) and 610 (proposed Instruction 6 to Item 27(d)(2): “[A]n ‘appropriate broad-based securities market index’ is one that is administered by an organization that is not an affiliated person of the Fund, its investment adviser, or principal underwriter, unless the index is widely recognized and used. A ‘broad-based index’ is an index that represents the overall applicable domestic or international equity or debt markets, as appropriate. Adjust the index to reflect the reinvestment of dividends on securities in the index, but do not reflect the expenses of the Fund.”).

<sup>10</sup> This does not presuppose that it will necessarily be easy to reproduce the index. For example, reproducing the index might reasonably require access to large amounts of marketplace data and/or sophisticated data analytics.

<sup>11</sup> Indeed, this flexibility is necessary as some of the best known market indexes today would not meet all the criteria set forth above. These criteria would allow the acceptance of many indexes currently in use or of future indexes that, though not in complete compliance with the standards set forth above, become widely accepted and trusted in the market. Although not contemplated in the Proposal, NASAA also suggests that the SEC should consider whether it would be simpler or preferable for the SEC to designate qualifying indexes by order.

example, actively managed funds that tend to focus on a particular segment of the market may reasonably consider a narrow secondary benchmark index to be appropriate.

**C. Responses to Questions 87, 89, 92, 93 and 95: The SEC Should Require Funds to Disclose Material Changes in Shareholder Reports and Set Standards for Such Disclosures.**<sup>12</sup>

The Proposal would add a new section to annual shareholder reports requiring the disclosure of material changes affecting the fund.<sup>13</sup> These disclosures would be optional in semi-annual reports.<sup>14</sup> NASAA supports this concept, but we believe several revisions or clarifications to the Proposal should be made.

We agree with the Proposal that “material changes” is the appropriate standard for this new disclosure obligation.<sup>15</sup> The concept of materiality is well developed in securities law. Funds should have no difficulty understanding it and, to the extent there are any ambiguities in its application, funds can err on the side of disclosure. A materiality standard also is higher than other standards the SEC might apply (such as a requirement to disclose “significant” or “substantial” changes).<sup>16</sup> If the SEC were to adopt a lower standard, funds would respond by disclosing non-material information, defeating one of the Proposal’s core purposes of helping retail investors easily access the most important fund disclosures.<sup>17</sup>

However, NASAA believes such material disclosures should be made both in annual and semi-annual reports. Without this change, investors could miss material disclosures if they do not

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<sup>12</sup> *Id.* at 141, Question 87 (“Should funds be required to disclose material fund changes in their annual reports, as proposed? ....”); 142, Question 89 (“Is the scope of the categories of fund changes in the proposed enumerated list appropriate? If not, how should we modify the scope? ....”); 143, Question 92 (“Instead of identifying particular types of material changes a fund must disclose in its annual report, as proposed, should we use a more principles-based or flexible framework for disclosing fund changes? ....”); and 144, Question 93 (“Does the proposed provision allowing funds to disclose additional material changes on a discretionary basis provide funds with appropriate flexibility to consider their particular facts and circumstances? ... Should we provide more flexibility by permitting funds to disclose other changes that may not necessarily be material to the fund? ...”) and Question 95 (“As proposed, should funds be required to disclose any material changes in their annual reports that occurred since the beginning of the fund’s last fiscal year (even if the fund has already disclosed any of these changes to existing shareholders, for example through prospectus supplements, notices under proposed rule 498B, or other non-shareholder report mechanisms)? Would it be beneficial for shareholders to see all of these changes summarized in a single place? ....”).

<sup>13</sup> *Id.* at 131-32.

<sup>14</sup> *Id.* at 174-75.

<sup>15</sup> We acknowledge that this will result in annual reports restating information previously disclosed by a fund in its most recent semi-annual report and in any prospectus update(s) during the reporting period, however we believe this result is preferable to making disclosure optional in semi-annual reports.

<sup>16</sup> *See id.* at 144 (Question 94).

<sup>17</sup> *See id.* at 1.

actively review ongoing prospectus updates.<sup>18</sup> Investors would be better served if they received notice of all material changes to their funds every six months through their annual and semi-annual shareholder reports.

We also support the proposed use of a prescribed list of items that would qualify as material changes. A prescribed list is preferable to a principles-based framework in this instance because funds need specificity here. A principles-based framework could result in excessive disclosure, as there are far more potentially material subjects that funds might feel compelled to disclose beyond those listed in the Proposal.

While the Proposal's enumerated material changes are all appropriate, we recommend the SEC add two more: changes to a fund's benchmark index(es) and the addition of any new fees.<sup>19</sup> A change in a fund's selection of either a broad-based securities market index or a secondary index should be disclosed as a material change because this could cause a fund instantly to appear to be a better investment. Even if an index change had no appreciable impact on a fund's perceived performance, the mere fact that a fund has changed indexes is something most investors would consider material and would want highlighted for them.<sup>20</sup> Further, while the Proposal would mandate disclosure of "[a]n increase in the fund's ongoing annual fees, transaction fees, or maximum account fee,"<sup>21</sup> it would be more protective for investors to mandate that any new fees be highlighted as well, irrespective of how the fees are characterized or the fees' potential magnitude.

**D. Responses to Questions 5, 6 and 8: The SEC Should Limit the Content of Shareholder Reports and Prohibit Incorporation by Reference, Should Not Set Page or Word Limits, and Should Permit Funds to Bundle Shareholder Communications.**<sup>22</sup>

NASAA supports the Proposal's shareholder report content limitations and prohibition on incorporation by reference.<sup>23</sup> These constraints would help to ensure that shareholder reports focus on the most important issues to investors and that investors would be able to understand the reports without consulting additional sources. However, shareholder reports should not be subject to strict

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<sup>18</sup> See *id.* at 23.

<sup>19</sup> See *id.* at 132-33.

<sup>20</sup> Further, in order to make the impact of such a change clear, the SEC should consider whether to require a fund to disclose a comparison between the old and new index for the first year of transition.

<sup>21</sup> *Id.* at 132.

<sup>22</sup> *Id.* at 59, Question 5 ("Is it appropriate to restrict the content of a fund's annual report to include only the information the form would permit or require? ....") and Question 6 ("Is it appropriate for funds to have flexibility to include other communications to shareholders in the same transmission as a shareholder report? Should the shareholder report be subject to the proposed prominence requirement? ...."); and 60, Question 8 ("Is it appropriate not to permit funds to incorporate information by reference into their annual reports, as proposed? ....").

<sup>23</sup> See *id.* at 55-57.

page or word limits. Funds should instead have the flexibility to provide explanatory or qualifying information to the extent they believe it is necessary or appropriate to do so.

On the other hand, and in the interest of consolidating and simplifying shareholder communications, we suggest that funds should be allowed to bundle shareholder reports with other documents in a single communication. With sufficient explanations, investors should be able to understand that a fund shareholder report followed by, for example, a summary of the fund's investment outlook constitutes two separate and distinct communications from the fund.<sup>24</sup> Appending additional materials behind a shareholder report (whether in a printed or electronic format) should not make investors less likely to read the report, and such bundling could be economical both in terms of the shareholder's time commitment and the fund's burdens.

**E. Responses to Questions 18, 216 and 219: The SEC Should Take Certain Steps to Improve Fee Disclosures in Fund Shareholder Reports, Prospectuses and SAIs.**<sup>25</sup>

NASAA supports the Proposal's simplified framework for fee disclosures in shareholder reports, prospectuses and SAIs.<sup>26</sup> Fund fee disclosures should give investors easy access to the "bottom line" or "all-in" costs of owning a fund. Third-party research and the SEC's own investor testing show this is what investors most want to know. Retail investors may not fully understand the various components that go into a fund's overall fee and expense structure. The Proposal takes meaningful steps to get investors the "bottom line" number while still ensuring they have access to the details of fund fees and expenses should they want to review this more detailed information. We support these measures, but recommend certain changes to the Proposal.

First, we believe the Proposal's shareholder report expense presentation could be misinterpreted where it uses the word "your." Under the Proposal, funds would be instructed to diagram for investors "What were your Fund costs for the period?" and outline the fund's costs "as a percentage of your investment" (emphases added).<sup>27</sup> An investor might reasonably interpret these uses of the possessive pronoun as actually reflecting that investor's own personal experience

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<sup>24</sup> See *id.* at 58. We also agree with the Proposal that shareholder reports generally should be given the greatest prominence in bundled communications. *Id.*

<sup>25</sup> See *id.* at 81, Question 18 ("Would the information that would be included in the proposed expense example permit shareholders to estimate the actual costs, in dollars, that they incurred over the reporting period and provide shareholders with a basis for comparing expenses across different funds? ...."); 279, Question 216 ("Is it appropriate not to require in the proposed summary or full fee table or example disclosure of brokerage commissions and other fees to financial intermediaries? ...."); and 281, Question 219 ("... Do commenters agree with our expectation that most funds would not include all of these line items, given the proposed instruction that any transaction fee equaling \$0 should not be included?").

<sup>26</sup> See *id.* at 69-81, 262-308.

<sup>27</sup> See *id.* at 70, 605. The SEC's hypothetical expense diagram also includes the footnote: "Certain Fund expenses, such as those associated with buying and selling fund investments, reduced your total return." (emphasis added). *Id.* This sentence too should be revised.

in the fund, not as generic expressions of the expenses incurred by a hypothetical fund investor. Accordingly, the word “your” should not be used in shareholder report expense presentations and the SEC’s guidance in the Proposal should be revised accordingly.<sup>28</sup>

Second, the footnotes to the shareholder report expense presentation should direct investors to where they can learn more about the fund’s costs, particularly fees or expenses not captured by the shareholder report expense presentation. The current footnotes make clear that the expense presentation does not necessarily reflect every fee or expense an investor might experience. It does not take the next logical steps, though, and help investors determine what those additional potential costs are and where they are disclosed. Funds should be required to do this.<sup>29</sup> Aside from the above changes to the expense presentation, though, we believe the Proposal’s revised shareholder report is well designed and will prove useful for retail investors.

NASAA also supports the Proposal’s revised fee disclosure framework in fund prospectuses and SAIs. The Proposal would replace the current fee table in the summary section of the statutory prospectus with a fee summary that focuses on the “bottom line” costs of owning the fund. Additional fee and expense information would be available through a more fulsome fee table and disclosures in the prospectus and SAI.<sup>30</sup>

We hope these reforms will have positive results for investors. One desirable benefit of simpler fee disclosures is that it will empower investors to compare the costs of different funds. As a result, funds may lower fees as each fund’s relative costs are made clearer. NASAA also hopes that the SEC will take the opportunity to scrutinize fund fees, and work to encourage funds to reduce or eliminate fees. We accordingly support these initiatives but suggest some revisions to them.

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<sup>28</sup> For example, the expense presentation guidance in the Proposal could be revised to: “*What were the Fund’s costs for the period?*”; “*Costs paid as a percentage of the hypothetical investment amount.*”; and “*Certain Fund expenses, such as those associated with buying and selling fund investments, reduced the Fund’s total return.*” (emphasis added). The shareholder report fortunately does not use the word “your” anywhere else besides the expense presentation, so this is the only part of the shareholder report in which this issue exists. See *id.* at 629-32 (Appendix A). Notwithstanding this change, though, we agree with the SEC’s general guidance that fund disclosures should use simple words like “you” or “we.” See *id.* at 159. Funds should simply be cautious about using possessive pronouns where doing so might reasonably confuse a retail investor.

<sup>29</sup> We would thus encourage the SEC to insert an additional sentence (such as the underlined sentence below) into the “†” footnote on page 70 of the Proposal: “*†In this footnote, the fund would be required to note in plain English that the actual costs paid during the period do not reflect certain costs paid outside the fund (such as purchase and exit costs charged by the shareholder’s broker-dealer. The fund also should provide instruction on where investors can find information about the fund’s fees and expenses in the fund’s other disclosures, including specific section or page references therein.*” This disclosure would help investors zero-in on precisely where in a fund’s lengthy prospectus and SAI fee and expense information can be found. Investors would have ready access to these documents through the proposed requirement that shareholder reports include statements on where fund disclosures can be found. See *id.* at 153-55. (The SEC should include in the proposed instructions to Item 27A(j) of Form N-1A that SAIs must be included on a fund’s website and referenced in a fund’s Item 27A(j) disclosures. See *id.* at 616-17.)

<sup>30</sup> See *id.* at 271-77.

The Proposal should be clearer about how funds should disclose transaction fees and account fees they do not use. The Proposal states in its guidance and in the proposed instructions to Item 3A of Form N-1A that prospectuses may omit from the summary fee table references to transaction or account fees the fund never charges.<sup>31</sup> The purpose of this guidance is to ensure that the summary fee table only includes fees and expenses that may be assessed to an investor. We believe the Proposal could be misinterpreted, though, as to whether funds may also omit these unused transaction or account fees from their full fee tables. We would accordingly encourage the SEC to revise the text of the Proposal to make clear that, while unused transaction and account fees should be omitted from the summary fee table, they still must be included in the full fee table pursuant to Item 8A of Form N-1A (*i.e.*, as a “\$0” transaction or account fee). The full fee table should enumerate all types of fees an investor could pay irrespective of whether a fund uses them in a particular instance. This would help investors compare the fee structures of different funds and remind investors of the types of fees funds could choose to charge.

In addition, the Proposal should require that funds identify as part of their prospectus fee disclosures where additional information about fees and expenses can be found in the fund’s SAI. The prospectus will contain the most salient fee and expense disclosures (through Items 3 and 8A of Form N-1A), but the SAI will invariably have additional details. To the extent investors desire to undertake this fee research, funds should be required to point them to the appropriate sections or pages of the fund’s SAI. Alongside our recommended changes to shareholder report fee disclosures discussed above, funds should thus be directed to help investors navigate the various fee and expense disclosures across the fund’s shareholder report, prospectus and SAI.

**F. Responses to Questions 257, 258 and 260: The SEC Should Require Summary Prospectus Risk Disclosures to be Shorter, More Tailored, and Rank Ordered.**<sup>32</sup>

NASAA supports the Proposal’s changed guidance for summary prospectus risk disclosures.<sup>33</sup> Summary prospectus risk disclosures have grown in length and have become incomprehensible for most retail investors.<sup>34</sup> In addition, some funds simply restate their full risk

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<sup>31</sup> See *id.* at 272, 515.

<sup>32</sup> See *id.* at 317, Question 257 (“*Is the proposed amendment to Form N-1A Item 4(b)(1)(i), which specifies that a fund should “briefly” summarize principal risks, appropriate? ...*”), Question 258 (“*Is the proposed new instruction to Item 4(b)(1)(i), providing that a fund in a complex should describe principal risks in order of importance, appropriate? ... Should the proposed instruction be more prescriptive as to how a fund should determine the significance of risk, and if so, what method for determining risks’ significance should the instruction specify ...?*”) and Question 260 (“*Is the proposed new instruction to Item 4(b)(1)(i), providing that a fund should tailor its risk disclosure to how each particular fund in the complex operates, appropriate?*”).

<sup>33</sup> See *id.* at 309-16.

<sup>34</sup> See *id.* at 310, n. 632 (citing research on the ballooning of summary risk disclosures), and 311 (noting the SEC staff has identified 7,000-word summary risk disclosures).

disclosures (prepared in response to Item 9 of Form N-1A) as their summary risk disclosures (in response to Item 4 of Form N-1A).<sup>35</sup> Funds should not be permitted to do this, as it obviates the purpose of Item 4. The SEC accordingly should tighten its guidance on summary risk disclosures.

Adding the word “briefly” to Item 4(b)(1)(i) of Form N-1A is a good first step as this would encourage funds to keep their summary risk disclosures short. We recommend the SEC go further, though, by adding an explicit instruction to Item 4 that funds should not simply restate their risk disclosures prepared in response to Item 9.<sup>36</sup> This instruction would force funds to go through the exercise of revising their Item 9 risk disclosures and preclude them from simply “copying-and-pasting” their Item 9 disclosures into Item 4.

Funds also should be required to tailor their prospectus risk disclosures to the specific investment profile of each investment series. In some circumstances, such as for short-term fixed income funds, different series of a fund may warrant identical or nearly identical risk disclosures. But this should not be the norm. Funds should be compelled to consider the risks associated with investing in each series and prepare risk disclosures accordingly. The new instruction to Item 4(b)(1)(i) of Form N-1A contained in the Proposal should accomplish this goal.<sup>37</sup>

In addition, funds should be required to rank order their prospectus summary risk disclosures. Rank ordering would help ensure that, to the extent investors review the summary risk disclosures, investors are presented with the most significant risks first. Doing so would minimize the possibility that an investor overlooks a fund’s most significant risks because they are placed at the end of the list. Indeed, ordering risks by significance to the fund is itself a useful form of disclosure.

However, we recommend that the SEC revise its proposed instructions on this issue.<sup>38</sup> Under the Proposal, funds would be able to use “any reasonable means of determining the significance of risks” and, consequently, of their appropriate rank ordering. The Proposal references probability and magnitude analyses, such as was adopted by the U.S. Supreme Court in *Basic Inc. v. Levinson*,<sup>39</sup> as one possible methodology.<sup>40</sup> But the Proposal presumes other reasonable methodologies may exist. We believe the SEC should set *Basic*’s probability and magnitude calculus as the only acceptable rank ordering methodology. This standard is well

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<sup>35</sup> *Id.* at 311.

<sup>36</sup> This new instruction could be Instruction 4 to Item 4(b)(1)(i). *See id.* at 517.

<sup>37</sup> *See id.* at 517 (Instruction 3: “A Fund should, where appropriate, tailor risk disclosures to how the Fund operates rather than rely on generic, standard risk disclosures.”).

<sup>38</sup> *See id.* (Instruction 2: “A Fund should describe principal risks in order of importance, with the most significant risks appearing first. A Fund may use any reasonable means of determining the significance of risks. A Fund should not describe principal risks in alphabetical order.”).

<sup>39</sup> 485 U.S. 224 (1988).

<sup>40</sup> *See Proposal* at 312.

known to the securities industry and is highly adaptable. Further, there should not be a compelling reason for a fund ever to use a different methodology.<sup>41</sup> Setting a single industrywide standard would ensure funds evaluate risks through a consistent lens, which in turn would help investors compare and analyze the risks associated with different funds.

### **III. Post-Implementation Suggestions**

Once the SEC adopts these proposed reforms, NASAA encourages it to undertake two post-implementation steps to ensure that the Proposal achieves the ends the SEC has set for it. First, the SEC should plan post-implementation testing and investor surveys to ensure that the new forms and disclosures are working as intended. These measures should be comparable to the investor testing and surveys that led the SEC to develop the Proposal. Second, NASAA encourages the SEC's Office of Investor Education and Advocacy to work with NASAA and state securities regulators in the development of new investor education materials to educate retail investors about these reforms. Given NASAA's focus on retail investor protection and the closeness of state securities regulators to retail investors, NASAA believes that such a collaboration would aid in empowering investors to understand and make the best use of the SEC's new open-end fund disclosure regime.

### **IV. Conclusion**

NASAA supports the Proposal and encourages its approval with the revisions outlined above. After these changes, shareholder reports would be shorter and more user-friendly, prospectuses would be more streamlined, and the densest and most voluminous disclosures would be shunted into SAIs. This would make it much easier for all investors to navigate and comprehend mutual fund disclosures. Hopefully, once these structural changes are implemented and absorbed by the marketplace, retail investors will be more likely to make use of them.

Thank you for considering these views. NASAA looks forward to continuing to work with the Commission in the shared mission to protect investors. Should you have questions, please contact either the undersigned or NASAA's General Counsel, Vince Martinez, at (202) 737-0900.

Sincerely,



Lisa Hopkins  
NASAA President  
General Counsel and Senior Deputy  
Commissioner of Securities, West Virginia

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<sup>41</sup> We doubt that any other bona fide methodology for rank ordering besides a *Basic* probability and magnitude calculus could exist.