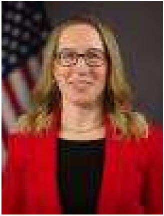
Statement

One Good Step, More to Go: Statement on Final Tailored Shareholder Reports for Mutual Funds and Exchange-Traded Funds; Fee Information in Investment Company Advertisements



Commissioner Hester M. Peirce

Oct. 26, 2022

Thank you, Chair Gensler. This shareholder report rulemaking represents a worthwhile next step in the Commission's ongoing effort to improve the quality and usability of mutual fund disclosure. I have questions and reservations about many of the choices we have made and believe the step forward could have been bigger. Nevertheless, the good here outweighs the bad, so I support this rulemaking.

The centerpiece of this rulemaking is a requirement that mutual funds and Exchange Traded Funds ("ETFs") provide shareholders with "concise and visually engaging annual and semi-annual reports." In a nutshell, today's changes will result in shareholder reports that contain only information that we have determined is most important to investors. Other information that we have deemed less critical will be made available online, delivered free on request, and filed twice a year on Form N-CSR in EDGAR.

Determining where to draw the line between what investors should receive in the shareholder report and what should be purged is not easy. Despite persistent attempts to expand what should be deemed must-have information, the drafting team largely stood strong and stuck to what is important. The resulting layered approach highlights key information, yet still allows more inquisitive investors to get additional disclosure.

While in general, this rule should improve the investor experience, several policy choices cut against that conclusion. For example, these amendments will permit a shareholder report to cover only the class of a multi-class fund in which the shareholder receiving the report has invested. Shareholder reports showing the range of share class options would allow fund investors to see cheaper class options available to them. In light of the Commission's recent spate of enforcement actions against advisers for failing to place clients in the most appropriate share class, this change from the proposal is particularly hard to understand.

Another puzzling aspect of this rulemaking is its elimination of e-delivery under rule 30e-3, which took effect only last year. Rule 30e-3 allows investment companies, instead of mailing full reports to shareholders, to provide a

notice stating that the reports are available online. Shareholders are still free to choose paper delivery. Rule 30e-3 has its flaws, but at the time of its passage, it represented a significant move toward a more rational approach to e-delivery.

I would have supported eliminating this option for funds if we were pivoting entirely to an access equals delivery approach. After all, after we adopted rule 30e-3, the pandemic hit, and people have become even more comfortable with receiving and interacting with everything online. The paper delivery default that riddles our rulebook belongs in the SEC archives.

Gutting rule 30e-3 is just the latest example of the Commission changing its mind about a new rule without any clear rationale for doing so. The Commission's reputation as a sober thoughtful regulator may suffer as the market learns to approach the implementation of new regulation with a jaded skepticism. "This time we mean it," is not a message we should find ourselves having to broadcast to allay the concerns of whipsawed compliance officers and bewildered investors. This Commission change of heart, which affects how funds communicate with their shareholders, is likely to be particularly confusing to investors.

We paired the cost-increasing decision not to let funds use rule 30e-3 with a decision not to adopt a cost-saving part of the proposal—proposed rule 498B. Proposed rule 498B would have required only new investors in a fund to receive a prospectus. Thereafter, funds would not have to send shareholders a copy of the prospectus. Existing shareholders would be notified of material changes and would be able to view the full prospectus online. Citing negative comments, we have decided to put this proposal on ice for "further consideration." From my review of the comments, many 498B supporters merely raised questions about particular aspects of the proposal – *e.g.*, calls for greater flexibility on timing regarding notice of a material event – but would have very much liked to have the option of putting this alternative into practice. This new rule had the potential to cut down on disclosure duplication and reduce costs.[1] So why are we throwing this option out altogether?

A similar question could be asked regarding the decision to jettison the small but important proposal related to Acquired Fund Fees and Expenses ("AFFE"). The proposal would have allowed mutual funds and ETFs that invest no more than 10% of their total assets in acquired funds to omit the AFFE line item in the fees and expenses table. Current AFFE disclosure requirements have dissuaded funds from investing in business development companies ("BDCs") because the AFFE associated with BDC investments is often high and therefore would adversely affect the investing funds' expense ratios. Because of this effect, some index providers exclude BDCs from their indices. The AFFE issue is part of the reason BDCs have yet to live up to their potential as a source for small businesses capital. As one commenter noted, when the Commission adopted the AFFE disclosure, it specifically wanted to avoid any "adverse impact on capital formation."[2] This proposal would have gone some way toward achieving that goal by, for example, potentially facilitating the reintroduction of BDCs into indices.

Speaking of indices, as proposed, the final rule will require funds to compare their performance to "an appropriate broad-based index," which is defined as "one that represents the overall applicable domestic or international equity or debt markets."[3] On substance, I find myself on the side of commenters who argued that the "requirement to compare a fund's performance to an index that is both 'broad-based' and 'appropriate' may, at times, conflict."[4] As one commenter pointed out "requiring a real estate fund to compare [itself] to an S&P Index would be misleading to investors that are investing in funds to gain exposure to the real estate segments of the market."[5]

What troubles me most about these decisions, however, is that they were based largely on conclusions drawn from a study by the SEC's Office of Investor Advocate that was not published until September 2022, two years *after* we proposed this rule and just one month before we are adopting it.[6] In other instances, the Commission has made available research and data used to inform final rules and amendments after a proposal's publication in the Federal Register; but, in this instance, the ink on this report is barely dry. When commenters are struggling to respond to proposals within already truncated comment periods, should we be asking them to be prepared to review and rapidly comment on material published well after a comment period has closed?

I have other concerns, including the overlap between our amended investment company advertising rules and FINRA's communications rules, but I think you get the point that today's rulemaking is not perfect. I can ultimately support it, however, because fund shareholders will benefit from this trimmed-down, layered approach to disclosure. I hold out the hope that we look at these changes as the beginning and not the end of an ongoing process. I offer my thanks to the staff of the Divisions of Investment Management, Economic and Risk Analysis, and Examinations, the Office of the General Counsel, and other offices throughout the Commission. Rulemakings like this one are at the heart of the Commission's mission, and I look forward to seeing these changes reflected in the disclosures shareholders receive.

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[1] *See* Comment letter from T. Rowe Price Group, January 5, 2021, https://www.sec.gov/comments/s7-09-20/s70920-8210190-227541.pdf ("We estimate that our funds and their shareholders will save approximately $5.4 million annually by relying on Rule 498B."). ("T. Rowe Comment").

[2] *See* Comment letter from Proskauer Rose LLP, January 4, 2021, https://www.sec.gov/comments/s7-09-20/s70920-8204291-227466.pdf.

[3] Proposal at 67.

[4] T. Rowe Comment.

[5] See Comment letter from Fidelity, January 4, 2021, https://www.sec.gov/comments/s7-09-20/s70920-8204333-227469.pdf.

[6] *See* Alycia Chin, Jonathan Cook, Jay Dhar, Steven Nash, and Brian Scholl, How Do Consumers Understand Investment Quality? The Role of Performance Benchmarks, Office of the Investor Advocate Working Paper 2022-01 ("Chin, et al."), available at https://www.sec.gov/files/performance-benchmarks-2022-01.pdf. See also Press Release, SEC, Office of the Investor Advocate Releases Research Study on Fund Performance Benchmarks (September 19, 2022) https://www.sec.gov/news/press-release/2022-165.