



Promoting Excellence in Fund Governance

December 22, 2020

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

*Re: 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 Number S7-09-20)*

Dear Ms. Countryman:

The Independent Directors Council<sup>1</sup> applauds the Securities and Exchange Commission's efforts to modernize the disclosure framework for open-end management investment companies.<sup>2</sup> In particular, we are pleased that shareholders would receive streamlined shareholder reports that would feature concise and visually engaging key information that is particularly important for retail investors to assess and monitor their fund investments. Independent directors, as representatives of shareholder interests, have a distinct and unique interest in promoting effective shareholder disclosure. IDC firmly believes that an effective disclosure framework will help investors be more informed about their investments.

The Commission's Proposal is comprehensive in scope. Our comments below focus on those topics that are of particular interest to fund directors.

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<sup>1</sup> The Independent Directors Council (IDC) serves the US-registered fund independent director community by advancing the education, communication, and policy priorities 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 (ICI) 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 \$25.8 trillion in the United States, serving more than 100 million US shareholders, and \$8.3 trillion in assets in other jurisdictions. There are approximately 1,600 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.

<sup>2</sup> SEC Release Nos. 33-10814; 34-89478; IC-33963 (August 5, 2020) ("Proposal"), *available at* <https://www.sec.gov/rules/proposed/2020/33-10814.pdf>.

## **The Proposal**

The Proposal contains comprehensive modifications to the open-end fund disclosure framework under which existing investors would receive streamlined shareholder reports. The following is a brief overview of those aspects of the Proposal most relevant to our letter.

Streamlined Shareholder Reports. Under the Proposal, the streamlined shareholder report would include, among other things, fund expenses, performance, illustrations of holdings, and a summary of the material fund changes that took place over the prior year. The Proposal would encourage open-end funds to use graphic or text features—such as tables, bullet lists, and question-and-answer formats. It would also provide flexibility for open-end funds to make electronic versions of their shareholder reports more user-friendly and interactive.

Certain information in an open-end fund's annual and semi-annual shareholder reports that the Commission considers less relevant to retail shareholders would be available online, delivered free of charge upon request, and filed on a semi-annual basis with the Commission on Form N-CSR.

Prospectus Disclosure. The Proposal also would amend a fund's prospectus disclosure requirements regarding fees, expenses, and principal risks. Among other things, the Proposal includes a new instruction to the prospectus principal risk disclosure requirements stating that a fund should describe its principal risks in order of importance, with the most significant risks appearing first.

Delivery of Information to Fund Investors. Under proposed Rule 498B, new investors would receive a fund prospectus in connection with their initial investment in an open-end fund, as they currently do, but funds could satisfy their obligation to deliver annual prospectus updates to existing shareholders thereafter so long as certain conditions are met. Conditions would include keeping shareholders informed through the shareholder report, including a summary in the annual report of material changes that took place over the prior year, as well as timely notifications of material fund changes throughout the year as they occur. Current versions of the fund's prospectus would remain available online and would be delivered upon request in paper or electronically, consistent with the shareholder's delivery preference.

Rule 30e-3. The Proposal would amend the scope of Rule 30e-3 to exclude open-end funds. This rule generally permits funds, beginning January 1, 2021, to satisfy shareholder report transmission requirements by making the reports and other materials available online and providing a notice of the reports' online availability, instead of directly providing the reports to shareholders. Investors who prefer to receive the full reports in paper may—at any time—choose that option free of charge. The Proposal would not affect the availability of Rule 30e-3 for other registered management companies, such as registered closed-end funds or registered unit investment trusts.

## Guiding Principles

IDC has long supported improvements to the quality of disclosures that investors receive.<sup>3</sup> Several key principles guide our recommendations in response to the Proposal:

- The most effective way to help shareholders become well-informed about their investments is to equip them with information that is clear, concise, understandable, and useful.
- Given the voluminous amount of information available about funds, it is critical that the disclosure is layered so that a summary of the key information that the average shareholder values the greatest is most prominent and accessible, while other, more detailed information that may only be of interest to a limited number of shareholders, is accessible and available through other disclosures.
- Electronic delivery should be the default method of transmission for shareholder disclosures, with the ability for shareholders at any time to affirmatively opt to receive paper.
- Fund disclosures should be cost-effective, as fund shareholders ultimately bear this expense.

## Streamlined Shareholder Report and Form N-CSR

IDC has consistently recommended that funds be permitted to deliver a summary shareholder report that includes certain key information, such as a fund's performance and expenses—organized in such a way as to help investors compare funds.<sup>4</sup> While we believe some targeted changes to the proposed

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<sup>3</sup> See, e.g., Letter from Dorothy A. Berry, IDC Governing Council Chair, to Elizabeth M. Murphy, Secretary, SEC, dated May 31, 2011 (supporting FINRA's proposal to require broker-dealers to make disclosures to investors about the cash compensation arrangements), available at <https://www.sec.gov/comments/sr-finra-2011-018/finra2011018-3.pdf>; Letter from Amy B.R. Lancellotta, IDC Managing Director, to Elizabeth M. Murphy, Secretary, SEC, dated September 15, 2009 (supporting the SEC's efforts to enhance the quality of disclosures made to investors), available at <https://www.sec.gov/comments/s7-13-09/s71309-85.pdf>; and Letter from Robert W. Uek, IDC Governing Council Chair, to Nancy M. Morris, Secretary, SEC, dated February 15, 2008 (supporting the SEC's summary prospectus proposal), available at <https://www.sec.gov/comments/s7-28-07/s72807-51.pdf>.

<sup>4</sup> See Letter from Amy B.R. Lancellotta, IDC Managing Director, to Brent J. Fields, Secretary, SEC, dated October 30, 2018 (supporting the SEC's efforts to consider advancements in technology and other developments to improve the fund retail investor experience), available at <https://www.sec.gov/comments/s7-12-18/s71218-4583862-176287.pdf>. See also Letter from Dorothy A. Berry, IDC Governing Council Chair, to Elizabeth M. Murphy, Secretary, SEC, dated March 23, 2012 (encouraging the Commission to move forward with streamlining the presentation of fund shareholder reports), available at <https://www.sec.gov/comments/4-645/4645-27.pdf>.

content of the report are in order,<sup>5</sup> IDC supports the Proposal in its creation of a streamlined summary shareholder report.

Board Information. With regard to information about board approvals of the fund's advisory contract and aggregate board compensation, the Proposal provides that the disclosure "is not well suited to the fund's shareholder report because it pertains less directly to a retail shareholder's understanding of the operations and performance of the fund and does not lend itself to the type of focused disclosure that the proposed annual report is designed to include."<sup>6</sup> The Commission, therefore, states that the disclosures may be better suited to be included in the fund's Form N-CSR where it would still be accessible to fund shareholders.

We agree and support these changes, as they would enable the shareholder report to more effectively focus on the information shareholders most care about, such as a fund's performance and expenses.<sup>7</sup> Importantly, consistent with a layered disclosure framework, each fund's statement of additional information, which is filed with the Commission, publicly available, and typically posted on the fund's website, also contains various disclosures about the fund's board. This information includes, among other things, the directors on the fund's board, the board's committee structure and each individual director's qualifications, share ownership, and compensation.

Clear and Accessible Information. The Proposal would require funds to post online all the information that would be newly filed on Form N-CSR. IDC strongly supports this requirement. We also believe that because the Proposal does not mandate any specific presentation of the disclosure on the fund's website, the SEC should encourage funds to present information in an easily accessible manner on the website. A fund that chooses to post its entire Form N-CSR on its website to satisfy the requirement to make the information available online should make the information easily accessible through, for example, the use of clear headers and hyperlinks to the relevant information.

Availability of Information about Fund Directors. As noted above, we believe that the streamlined shareholder report requirements should be limited to the most essential information that is important to investors. To the extent that shareholders, however, wish to learn about the boards and their directors, that information should be easily available. To enhance the accessibility of board-related information for investors who may be interested, we recommend that a fund be permitted, but not

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<sup>5</sup> See Letter from Eric J. Pan, ICI President & CEO, to Jay Clayton, Chairman, SEC, dated December 21, 2020, *available at* [https://www.ici.org/pdf/20\\_ltr\\_disclosurecover.pdf](https://www.ici.org/pdf/20_ltr_disclosurecover.pdf), and Letter from Susan Olson, ICI General Counsel, and Dorothy Donohue, ICI Deputy General Counsel, to Vanessa Countryman, Secretary, SEC, dated December 21, 2020 (providing recommendations to the changes contained in the Proposal), *available at* [https://www.ici.org/pdf/20\\_ltr\\_disclosure.pdf](https://www.ici.org/pdf/20_ltr_disclosure.pdf).

<sup>6</sup> The Proposal, *supra* n. 2 at p. 212.

<sup>7</sup> See ICI Research Perspective, What US Households Consider When They Select Mutual Funds, 2019 (April 2020), *available at* <https://www.ici.org/pdf/per26-02.pdf>.

required, to include a brief statement in its shareholder report about the role of the fund's board of directors in overseeing the fund and how shareholders can find more information about the board. Consistent with the layered approach to disclosure, the brief statement could hyperlink to, or, if in paper, reference available information about the fund board and its directors.

### **Rule 30e-3**

The Proposal would amend the scope of Investment Company Act Rule 30e-3 to exclude open-end funds. Recently adopted Rule 30e-3 generally permits funds, beginning January 1, 2021, to satisfy shareholder report transmission requirements by making the reports and other materials available online and providing a notice of the reports' online availability, instead of directly providing the reports to shareholders. Investors who prefer to receive the full reports in paper may—at any time—choose that option free of charge.

IDC supported Rule 30e-3 when it was initially proposed because of anticipated clear benefits to shareholders, including potentially significant cost savings.<sup>8</sup> Since directors oversee fund expenses on behalf of shareholders, they have a strong interest in regulatory changes that could impact unnecessary fund expenses. We understand that the majority of fund complexes plan to begin relying on Rule 30e-3 beginning in January 2021 and have invested a great deal of resources in preparing for the transition. We therefore question why the rule would be discarded for open-end funds at this point in time, particularly given the extensive resources that have been devoted toward compliance with the rule.

Moreover, because of their role in representing shareholder interests, directors are particularly sensitive to matters that could cause investor confusion. Fund complexes, in anticipation of reliance on Rule 30e-3, have already communicated to their shareholders multiple times in various communications about how shareholder reports will be delivered. Changing that framework so soon after it becomes effective would inevitably cause investor confusion.

We also believe that funds should be able to evaluate and choose optimal delivery options for their shareholders based on investor preference. According to a recent ICI survey ("ICI Survey"), few direct-at-fund accounts asked for paper shareholder reports in response to fund requests related to complying

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<sup>8</sup> See Letter from Amy B.R. Lancellotta, IDC Managing Director, to Brent J. Fields, Secretary, SEC, dated August 11, 2015 (commending the SEC for proposing rule 30e-3), available at <https://www.sec.gov/comments/s7-08-15/s70815-303.pdf>. See also Letter from Amy B.R. Lancellotta, IDC Managing Director, to Brent J. Fields, Secretary, SEC, dated May 10, 2016 (underscoring strong support for proposed rule 30e-3), available at <https://www.sec.gov/comments/s7-08-15/s70815-592.pdf>; Letter from Amy B.R. Lancellotta, IDC Managing Director, to Brent J. Fields, Secretary, SEC, dated September 12, 2016 (urging the adoption of proposed rule 30e-3 for its anticipated significant benefits to fund shareholders), available at <https://www.sec.gov/comments/sr-nyse-2016-55/nyse201655-6.pdf>.

with Rule 30e-3.<sup>9</sup> This data suggests that the mechanisms allowed by Rule 30e-3 are broadly aligned with fund shareholders' disclosure preferences. Accordingly, we urge the Commission to preserve the ability of open-end funds to choose to rely on Rule 30e-3.

## **Electronic Delivery**

IDC urges the Commission to permit funds to electronically deliver disclosure documents to shareholders so long as shareholders receive advance notice and are able to affirmatively choose to receive documents in paper at any time, free of charge. Technology has transformed the way that information is delivered, accessed, and consumed. The SEC's disclosure approach should reflect the real and definite shift that has occurred over decades, particularly since the vast majority of US households owning mutual funds have internet access.<sup>10</sup>

The ICI Survey also found that 96 percent of fund companies responding to the survey offer electronic delivery of investor materials and a majority of direct-at-fund accounts with email addresses opted into electronic delivery of several important fund disclosure documents. In addition, 24 percent of ICI Survey respondents reported a positive spike in requests for e-delivery from direct-at-fund accounts since the beginning of the COVID-19 pandemic, with two of those experiencing an uptick of 17 percent.<sup>11</sup>

As SEC Chairman Jay Clayton recently recognized, the Commission should consider "how to best and promptly update our guidance to make it easier for funds, advisers and investors to use electronic delivery, while ensuring that any investor who wants paper delivery remains fully able to receive it .... [O]ur efforts to meet the challenges presented by COVID-19 have unquestionably demonstrated that our regulations should not cling to the mails and paper as the default or preferred paradigm for communications."<sup>12</sup>

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<sup>9</sup> ICI survey respondents managed approximately \$18 trillion of mutual fund assets, representing approximately 85 percent of industry mutual fund assets at the end of June 2020. See Letter from Dorothy M. Donohue, Deputy General Counsel, Sarah Holden, Senior Director, Retirement & Investor Research, and Joanne Kane, Senior Director, Operations & Transfer Agency, Investment Company Institute, to Dalia Blass, Director, Division of Investment Management, SEC, dated September 10, 2020, (including complete survey results), available at <https://www.sec.gov/comments/265-33/26533-7964920-224992.pdf>.

<sup>10</sup> *ICI Research Perspective*, Ownership of Mutual Funds, Shareholder Sentiment, and Use of the Internet, 2020 (November 2020), available at <https://www.ici.org/pdf/per26-08.pdf>.

<sup>11</sup> See *supra* n. 9.

<sup>12</sup> See Chairman Clayton, Opening Remarks at November 5, 2020 Asset Management Advisory Committee available at <https://www.sec.gov/news/public-statement/clayton-amac-2020-11-05>. See also Letter from Dorothy M. Donohue, Deputy General Counsel – Securities Regulation, Sarah Holden, Senior Director, Retirement & Investor Research, and Joanne Kane, Senior Director, Operations & Transfer Agency, ICI, to Jay Clayton, Chairman, SEC, dated December 10, 2020,

In addition, the Commission's Asset Management Advisory Committee recognized the need for the Commission to embrace electronic delivery. In a recent meeting, the Committee unanimously voted to recommend that the SEC permit firms to use an investor's digital address, such as an email or smart phone telephone number, as the primary address when delivering regulatory documents, and incorporate appropriate investor protection principles that include notice, choice and safeguards.<sup>13</sup>

The Commission is therefore well positioned to take action in this area. Electronic delivery would facilitate easy access to all the information a shareholder may wish to access through the use of hyperlinks and optimizes the notion of a layered approach to disclosure. We strongly believe changing the default for shareholders to receive disclosure documents electronically, rather than requiring them to opt in to receive documents electronically, would align with their preferences in receiving communications, help them be more informed about their investments, and enable them to benefit from the cost savings.

### **Reliance on Disclosure Reforms**

We recognize the possibility of certain unintended consequences as a result of providing shareholders with streamlined disclosure documents and providing for a layered disclosure framework. In particular, changes in the use of streamlined shareholder reports in lieu of more detailed annual reports, the use of prospectus updates for existing shareholders rather than the annual delivery of updated prospectuses, and the ordering of risk disclosure<sup>14</sup> each may carry with it an increased and unintended risk of assertions that a fund did not provide adequate disclosure to its shareholders. We therefore recommend that the Commission confirm in any adopting release that the amendments are not intended to alter the total mix of information available to shareholders or otherwise affect how courts should assess fund disclosures for purposes of shareholder litigation.

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(offering supplemental information supporting the Commission facilitating electronic delivery of information to fund shareholders), *available at* [https://www.ici.org/pdf/20\\_ltr\\_secedelivery.pdf](https://www.ici.org/pdf/20_ltr_secedelivery.pdf).

<sup>13</sup> See U.S. Securities and Exchange Commission, Asset Management Advisory Committee, Preliminary Recommendations of Operations Panel Regarding COVID-19 Operational Issues, November 5, 2020, *available at* <https://www.sec.gov/spotlight/amac/operational-issues-amac-recommendations-final-110520.pdf>.

<sup>14</sup> The Proposal would require a fund's prospectus to describe the fund's principal risks in order of importance, with the most significant risks appearing first, and would prohibit a fund from describing principal risks in alphabetical order. We believe that this approach suggests a false degree of precision and would likely leave the disclosure vulnerable to second guessing with 20/20 hindsight. In addition, we note the inconsistency between the Proposal and the more principles-based approach taken by the SEC in its August 2020 amendments to Regulation S-K. See Modernization of Regulation S-K Items 101, 103, and 105, Securities Act Release No.10825, dated August 26, 2020, *available at* <https://www.sec.gov/rules/final/2020/33-10825.pdf>. Accordingly, we have strong concerns regarding this aspect of the Proposal and urge the Commission to take a more principles-based approach.

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We appreciate the opportunity to comment on the Proposal. If you have any questions regarding our comment letter or would like additional information, please contact Lisa Hamman, Senior Associate Counsel, at (202) 371-5405 or me at (202) 326-5463.

Sincerely,



Thomas T. Kim  
Managing Director  
Independent Directors Council

cc: The Honorable Jay Clayton  
The Honorable Hester M. Peirce  
The Honorable Elad L. Roisman  
The Honorable Allison Herren Lee  
The Honorable Caroline A. Crenshaw

Dalia O. Blass, Director  
Paul Cellupica, Deputy Director and Chief Counsel  
Brent Fields, Associate Director of Disclosure Review and Accounting  
Sarah ten Siethoff, Associate Director, Rulemaking Office  
Amanda Wagner, Branch Chief  
Division of Investment Management