CENTER FOR CAPITAL MARKETS COMPETITIVENESS

TOM QUAADMAN
EXECUTIVE VICE PRESIDENT

1615 H STREET, NW
WASHINGTON, DC 20062-2000
(202) 463-5540
tquaadman@uschamber.com

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

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 (Release No. 34-89478, IC-33963; File No. S7-09-20)

Dear Ms. Countryman:

The Center for Capital Markets Competitiveness ("CCMC") is pleased to provide comments on the proposal issued by the Securities and Exchange Commission ("SEC" or "Commission"), "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." ("Proposal")

The CCMC commends the Commission for its ongoing work to modernize disclosure and securities regulation to reflect technological innovation and the evolving preferences of investors. The Proposal also rightfully reaffirms the principal of materiality for fund disclosure and will ensure that investors receive decision-useful information regarding the funds in which they invest.

As the Commission noted in a 2015 rule proposal, a 2011 investor survey conducted by the SEC found that nearly two-thirds of investors said they prefer to view a mutual fund prospectus online while only one-quarter stated they would request a prospectus by mail.[1] Recent data also indicate that individuals increasingly choose electronic methods when it comes to transactions concerning their finances. For example, 89% of individual tax returns were filed electronically in 2019[2], while 93% of mortgage lenders provide borrowers with the option of

[1] Investment Company Reporting Modernization (File No. S7-08-15)
[2] Returns Filed Taxes Collected and Refunds Issued | Internal Revenue Service (irs.gov)

completing mortgage applications online.[3] Additional advances in technology and the increased ability to access information on the internet have only furthered these trends over the last decade.

The Proposal makes several improvements to the disclosure regime for mutual funds and recognizes the need to update disclosures related to business development companies (BDCs). However, we believe certain modifications to the Proposal are necessary for it to have its intended impact.

Accordingly, the CCMC makes the following recommendations:

1) **Acquired fund fees and expenses ("AFFE") disclosure should be removed from the prospectus fee table to a footnote for all funds, as opposed to only funds with a certain percentage of assets invested in other funds;**

2) **Rule 30e-3 should be maintained to allow funds to provide notice-and-access to shareholders regarding the availability of fund documents online;**

3) **Proposed Rule 498B should be adopted largely as proposed, however should clarify that funds which rely on 498B will not be subject to increased enforcement or litigation risk.**

Recommendations

Acquired fund fees and expenses ("AFFE") disclosure should be removed from the prospectus fee table to a footnote for all funds, as opposed to only funds with a certain percentage of assets invested in other funds.

The Proposal would permit a fund that invests 10% or less of its total assets in "acquired funds" to disclose AFFE in a footnote as opposed to the prospectus fee table. This provision is in part an effort to address longstanding concerns regarding the impact upon BDCs and their investors. As the Chamber and many other organizations have explained, current AFFE disclosure as it applies to BDCs is fundamentally misleading and effectively "double counts" the true cost of investing in BDCs. This has resulted in the exclusion of BDCs from certain indices and an outflow of institutional investment.

Business development companies are a critical source of capital for small and medium-sized businesses throughout the United States. Since their creation by Congress in 1980, BDCs have offered a unique form of financing through a highly regulated investment vehicle. BDCs also provide a means for investors – particularly retail investors – to invest in private middle market companies that are a critical source of growth and innovation in the U.S. economy. Historically, only the wealthiest Americans or institutional investors have been able to invest in

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[3] Ellie Mae Survey Uncovers How Technology Is Changing the Mortgage Lender and Borrower Experience | Business Wire

these markets; BDCs help expand access to these companies to Main Street investors looking to diversify their investment portfolios.

The role of BDCs has become particularly important over the last decade as nonbank financing has increasingly become a favored source of capital for small and middle market businesses. The COVID-19 pandemic and severe economic disruptions have also demonstrated the importance of BDCs to Main Street businesses. In fact, earlier this year the SEC provided temporary exemptions for BDCs from certain regulations so that they can continue to deploy capital to the businesses that need it most.[4] The SEC's actions were a recognition that regulations can sometimes have unintended economic consequences and that the SEC should continuously monitor and update rules that may be creating most costs than benefits.

Such is the case with AFFE. In 2006, the SEC adopted the AFFE requirement to "provide investors with a better understanding of the actual costs of investing in a fund that invests in other funds." The AFFE rule requires a fund to include as an additional line item in its prospectus fee table the pro rata share of the expenses of a fund it has acquired. This is coupled with the operating expenses of the acquiring fund to show that fund's total expense ratio. While the intent of the AFFE rule is to better inform investors about the expenses they pay under a fund of funds arrangement, the disclosure itself is fundamentally misleading and creates confusion for investors. The AFFE disclosure suggests that the expenses of an acquired fund (for example a BDC) are *in addition to* the operating expenses of the acquiring fund.

In reality, the fees of an acquired BDC are indirect expenses that are not paid by the acquiring fund's shareholders and are already reflected in the financial returns the BDC investment produces for the acquiring fund. As a result, subtracting a BDC's expenses from its financial returns while adding them to the acquiring fund's fee table "double counts" those expenses, thereby misinforming investors as to the true cost of investing in the acquiring fund.

While the 10% threshold in the Proposal is a step in the right direction, the CCMC is concerned that it would not fully address the underlying problem for BDCs and their investors. It is also unlikely that the 10% threshold would result in index providers re-including BDCs in certain indices as it would establish differing standards for acquiring funds that have invested in other funds. For example, fee table disclosure for a fund with 9% of its assets in acquired funds would look starkly different than for a fund that has 11% of its assets in acquired funds. Rather than helping investors better understand the cost of investing in funds, such a two-tiered system would create greater confusion.

At the open meeting, Commissioner Peirce asked "Would it make more sense for all AFFE disclosure to be in the footnotes?" The CCMC believes the answer is yes. Providing investors with fee table disclosure about the true costs of investing in BDCs should not be depending on the mutual fund that happens to be invested in the BDC. Allowing for the removal of AFFE to the footnotes for all funds – regardless of the percentage of assets they have in

[4] Order under Sections 6(c), 17(d), 38(a), and 57(i) of the Investment Company Act of 1940 and Rule 17d-1 thereunder granting exemptions from specified provisions of the Investment Company Act and certain rules thereunder (April 8, 2020).

acquired funds – is the only way to provide a uniform, lasting solution to the misrepresentations caused by the current AFFE requirement.

Rule 30e-3 should be maintained to allow funds to provide notice and access to shareholders regarding the availability of fund documents online

In 2018, the Commission adopted Rule 30e-3 which allows funds to comply with shareholder report delivery requirements by notifying shareholders that such reports are available online, known as "notice and access." Rule 30e-3 was issued after a years-long effort by the SEC to examine how investors were using technology to access shareholder reports s as opposed to reading paper documents. The Commission noted when the rule was finalized, Rule 30e-3 "will improve investors' ability to access and use [shareholder report] information, while reducing expenses associated with printing and mailing that are borne by funds, and ultimately, by their investors." The CCMC strongly supported the adoption of Rule 30e-3.

The Investment Company Institute has previously estimated that the processing fees for the printing and delivery of shareholder reports exceeds $1 billion over a 10-year period[5] and investor outreach conducted by the SEC has found an unmistakable preference by the vast majority of investors to view reports online as opposed to paper. Earlier this year, the Department of Labor finalized a rule that will allow for greater electronic access of documents related to retirement plans under the Employee Retirement Income Security Act (ERISA).[6] Importantly, Rule 30e-3 would allow investors to continue to receive paper mailings of shareholder reports if they choose to do so.

The Proposal would effectively rescind Rule 30e-3 for open-end funds, which is set to go into effect on January 1, 2021. The Commission explains that other aspects of the proposal – notably the layering of disclosure and more concise shareholder reports – obviate the need for Rule 30e-3 to remain in effect. The CCMC respectfully disagrees. We believe that Rule 30e-3 properly reflects the growing investor preference for electronic access to disclosures and should remain in effect regardless of changes to the disclosure framework included in the Proposal or any future Commission rulemaking.

Further, fund providers have spent the last two years preparing to comply with Rule 30e-3. Given the effective date of January 1, 2021, even on an expedited basis it is unlikely the Commission could finalize the Proposal before the end of 2021 – with an expected 12-24 month implementation timetable. That means even if the Commission were to ultimately rescind Rule 30e-3, it would have been in effect for at least two years and investors would have become accustomed to the rule. "Undoing" such a rule soon after it has gone into effect serves no useful purpose and would only create confusion for investors. For these reasons, we believe the Commission should retain and not make any amendments to Rule 30e-3.

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[5] ICI Comment Letter to SEC Re: Supplemental Comments on Investment Company Reporting Modernization (File No. S7-08-15).

[6] U.S. Department of Labor Announces Rule to Better Deliver Retirement Plan Information Options, While Saving Billions of Dollars for Plans | U.S. Department of Labor

Proposed Rule 498B should be adopted largely as proposed, however should clarify that funds which rely on 498B will not be subject to increased enforcement or litigation risk

The Proposal would establish new Rule 498B, which would ensure that new shareholders are provided with a copy of the fund's prospectus, but would allow funds to provide existing shareholders with tailored reports that include a summary of material changes to the fund, i.e. funds would not be required to send existing shareholders prospectus updates every year. We believe this new rule properly balances the need to provide shareholders with decision-useful information without overloading them with duplicative fund documents.

However, the CCMC believes the Commission should clarify as part of the final rule (or through subsequent guidance) that reliance on Rule 498B should not increase litigation risk for funds on the grounds that they have not properly disclosed certain risks or other factors in a tailored annual shareholder report if those risks are disclosed in the fund's prospectus. Funds may make a determination to include discussion about certain risks in the fund's annual prospectus and not in the annual shareholder report, leaving them open to criticisms that they have somehow hidden information from investors. Given that shareholders would be provided throughout the year with up to date information – through shareholder reports sent to them as well as the availability of the fund's prospectus online – we believe that the Commission should clarify that reliance on Rule 498B would not impact a fund's responsibility to provide shareholders with the total mix of information available.

Conclusion

The CCMC believes that with the changes outlined above, the Proposal will help better inform fund investors about the risks and costs associated with certain fund investments. We appreciate the Commission's leadership on these important issues and look forward to working with the Commissioners and SEC staff as this initiative moves forward.

Sincerely,

Tom Quaadman