

**Recommendation of the Investor as Purchaser Subcommittee  
Regarding Promotion of Electronic Delivery and Development of a Summary Disclosure  
Document for Delivery of Investment Company Shareholder Reports**

**Background**

- As a large majority of investors have gained access to the Internet and become comfortable using it for a variety of purposes, including researching investments, mutual fund companies and other securities firms have sought to reduce disclosure delivery costs by speeding the transition to electronic delivery of mutual fund disclosure documents.<sup>1</sup>
- Investor advocates have also noted the potential for electronic delivery to enhance the quality and timeliness of disclosures, including by promoting greater use of layered disclosures,<sup>2</sup> but only if the transition to electronic delivery occurs in a way that maximizes the likelihood that investors will see and read those disclosures.
- While investor acceptance of electronic delivery has grown in recent years, nearly half of investors (49%) still prefer to receive paper disclosures through the mail, compared with only 33% who prefer to receive disclosures electronically, either through email (27%) or accessing them online (6%), according to recent survey data from the FINRA Investor Education Foundation.<sup>3</sup>
- In May 2015, the Commission proposed Rule 30e-3 to allow mutual fund companies to default investors to electronic delivery of annual shareholder reports based on negative consent.<sup>4</sup> While the proposal enjoyed strong support from the fund industry, who noted its potential to reduce costs, it met with significant resistance from investor advocates, who maintained that an approach that relies on website disclosure and negative consent would reduce the likelihood that investors would see and read the disclosure documents.
- During discussions of the issue, including at a meeting of the IAC, both fund industry representatives and investor advocates voiced strong support for a layered approach to disclosure for annual shareholder reports, modeled on the summary prospectus rule, in which investors would receive a brief summary of key information from the annual report in a disclosure notifying them of the full report's availability.
- It has been suggested that allowing funds to satisfy their delivery obligations through delivery of a summary document could produce many of the cost savings associated with the SEC's 30e-3 proposal without presenting the same concerns that disclosure effectiveness would be compromised.

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<sup>1</sup> Electronic delivery of disclosure has been permitted under guidance adopted by the Securities and Exchange Commission (SEC) in the mid-1990s, subject to notice, access, and delivery requirements. See, e.g., SEC Release NO. 33-7233; 34-36345; IC-21399, <https://www.sec.gov/rules/concept/33-7233.txt>.

<sup>2</sup> See, e.g., Roper, Barbara, "Can the Internet Transform Disclosures for the Better?" Consumer Federation of America, January 2014 <http://bit.ly/1CwEbjS>

<sup>3</sup> FINRA Investor Education Foundation, "Investors in the United States 2016," December 2016, available at <http://bit.ly/2hMrppX>.

<sup>4</sup> To date, the SEC has not approved the rule proposal.

## Recommendation

The Investor Advisory Committee recommends that the Commission continue to explore methods to encourage a transition to electronic delivery that respect investor preferences and that increase, rather than reduce, the likelihood that investors will see and read important disclosure documents. In the meantime, the IAC recommends that the Commission explore development of a summary disclosure document for annual shareholder reports that incorporates key information from the report along with prominent notice regarding how to obtain a copy of the full report. The summary document should be designed to be delivered either by mail or by email, depending on the investors' delivery preferences. It should also incorporate a layered disclosure approach, including the ability of those getting the document electronically to click through to more detailed disclosure on a particular topic. The Committee recommends that the Commission seek public comment on the appropriate content and format of such a disclosure document, as well as on the advisability of the suggested approach more generally. The Committee further recommends that the Commission engage in investor testing of the proposed disclosure, or encourage testing by industry members, to ensure that the proposed approach delivers the expected benefits of reducing costs for funds and distributors without sacrificing disclosure quality.

## Discussion

In May of 2015, the Commission proposed a broad package of new rules and amendments to existing rules with a goal of modernizing Investment Company reporting.<sup>5</sup> Included in the package was a proposed new rule 30e-3 under the Investment Company Act, which would permit mutual fund companies to satisfy their delivery requirements for periodic shareholder reports by making the reports accessible on a website and meeting certain other conditions. To satisfy the rule, the fund's report to shareholders would have to be publicly accessible, free of charge, at a specified website address. The rule would permit funds to default investors to electronic delivery based on negative consent where the investor had received written notice, at least 60 days prior to the time the company planned to begin relying on the rule, notifying the shareholder of the fund's intent to make future shareholder reports available on the fund's website until the shareholder revokes consent. In addition, fund companies would be required under the proposed rule to provide separate notice to shareholders each time a report is posted, alerting shareholders to the availability of the report online and providing them with information on how to obtain a paper copy if they want one.

The proposal received strong support from the fund industry. The Investment Company Institute wrote, for example, to express its enthusiastic support for adoption of rule 30e-3.<sup>6</sup> "Not only would the proposed rule satisfy investor preferences, it has the potential to save fund shareholders an estimated \$140 million per year on a net basis in the first three years of adoption," ICI wrote. ICI urged the Commission to extend the implied consent delivery approach to prospectuses and suggested other changes to eliminate certain aspects of the notice

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<sup>5</sup> SEC File No. S7-08-15, Investment Company Reporting Modernization, May 20, 2015 <http://bit.ly/1Pp1qwt>

<sup>6</sup> August 11, 2015 letter from ICI General Counsel David W. Blass to SEC Secretary Brent J. Fields, regarding Investment Company Reporting Modernization and Amendments to Form ADV and Investment Adviser Act Rules, File Nos. S7-08-15 and S7-09-15 <http://bit.ly/2vbAy1o>

requirements, including, for example, the requirement to provide shareholders with a pre-addressed, postage paid reply form to use if they preferred to receive the reports in paper. Similarly, the Independent Directors Council wrote to express its view “that proposed rule 30e-3 would deliver significant benefits to fund shareholders, without impeding investor protection concerns.”<sup>7</sup> The letter states that, “The benefits of online delivery of shareholder reports are straightforward and significant. The potential cost savings for funds and, ultimately, their shareholders is unequivocally the primary benefit.”

The proposal was strongly opposed by certain investor advocates, who objected in particular to the rule’s reliance on negative consent to default investors to electronic delivery via website posting of the reports. Consumer Action and National Consumers League, for example, wrote in opposition to the proposal, stating that “the true cost of Rule 30e-3 is decreased transparency and investor access to information.”<sup>8</sup> These consumer groups noted that, while consumers want to have access to information online, research suggests a majority of consumers prefer to receive important disclosure documents in paper. They noted that investors who prefer electronic delivery already have that option, and the rule “only increases the work investors [who prefer paper delivery] must exercise to preserve their choice.” Consumer Federation of America also wrote in opposition to the rule, stating that the Commission had failed to make the case that the rule was “either needed or warranted.”<sup>9</sup> CFA wrote that, “we simply have not yet reached the point in this country where a sufficient percentage of investors prefer to receive disclosures electronically to justify a default to electronic delivery. While we feel certain that day will eventually arrive, a premature move to electronic delivery based on implied consent ensures that fewer investors will receive and review the important disclosures these documents are intended to provide.”

The Investor Advisory Committee had a panel presentation and discussed the issue at its July 2016 meeting.<sup>10</sup> While supporting views were also expressed, a number of IAC members voiced opposition to the proposal’s reliance on negative consent to change the delivery default and suggested that potential savings to shareholders were insufficient to justify the proposed change. Over the course of the discussion, however, a number of participants expressed support for a layered approach to disclosure, using a summary document modeled loosely on the mutual fund summary prospectus.

Ultimately, the Commission approved the broader package of Investment Company reporting reforms in October of 2016 without including proposed rule 30e-3.

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<sup>7</sup> May 10, 2016 letter from IDC Managing Director Amy B.R. Lancellotta to SEC Secretary Brent J. Fields, regarding Supplemental Comments on Investment Company Reporting Modernization; File No. S7-08-15 <http://bit.ly/2uypzvv>

<sup>8</sup> April 12, 2016 letter from Consumer Action Director of National Priorities Linda Sherry and National Consumers League Executive Director Sally Greenberg to SEC Secretary Brent J. Fields, regarding Investment Company Reporting Modernization Proposed Rule; Release Nos. 33-9776; 34-75002; IC-31610; File No. S7-08-15; S7-16-15 <http://bit.ly/2vFQk67>

<sup>9</sup> July 29, 2015 letter from CFA Director of Investor Protection Barbara Roper to SEC Secretary Brent J. Fields, regarding Investment Company Reporting Modernization, File No. S7-08-15 <http://bit.ly/2vGd463>

<sup>10</sup> July 14, 2016 meeting of the SEC Investor Advisory Committee webcast <http://bit.ly/2vGetJS>

Since that time, the Investor as Purchaser Subcommittee has explored development of a summary document along the lines discussed by the IAC. As conceived by the Subcommittee, the document would include prominent notice of the availability of the full report and information on how to obtain it, along with key highlights from the report itself. For example, the document might include information on fund costs, performance and fund holdings. The IAC believes an approach along these lines has the potential to deliver cost savings to industry without unduly compromising disclosure effectiveness. We therefore recommend that the Commission further explore this approach through investor testing, either through field tests or other means. Based on the findings of that investor testing, the Commission should consider further rulemaking, with an opportunity for public comment on the proposed approach as well as the details of the content and format for the proposed enhanced notice document.

The IAC further believes that the Commission should continue to explore alternative approaches to encourage the transition to electronic delivery. In doing so, it should seek to ensure that investor preference regarding delivery methods is respected, including by continuing to distinguish between investors' preferences with regard to research, where a large majority prefer accessing information on the Internet, and delivery of disclosures, where a plurality appears to continue to prefer receiving paper documents through the mail. In addition, the Commission should encourage development of approaches to electronic delivery that promote, rather than reduce, the likelihood that investors will see and read the disclosures. And it should engage in testing to help determine, to the extent possible, that its proposed approach has the intended effect.