



Consumer Federation of America

July 29, 2015

Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Investment Company Reporting Modernization
File No. S7-08-15

Dear Secretary Fields:

I am writing on behalf of the Consumer Federation of America (CFA)¹ to express our opposition to proposed new Rule 30e-3, which would permit funds to shift the default for delivery of certain shareholder reports from delivery of paper documents by mail to electronic delivery. The Commission fails to make the case that this rule change is either needed or warranted. We reach this conclusion despite our belief that well designed Internet disclosures have the potential to improve the quality of disclosure. The fact remains, however, 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. We therefore strongly urge the Commission to withdraw proposed Rule 30e-3.

1) Shareholder Reports Provide Investors with Valued Information.

Mutual fund investors receive valued information from annual and semiannual shareholder reports. This includes information that can help them assess both the costs they are paying to hold the fund and the fund's performance over the previous period, as well as a listing of fund holdings. These are subjects in which investors expressed a strong interest when surveyed for the Siegle & Gale study, conducted on behalf of the Commission, "Investor Testing of Selected Mutual Fund Annual Reports (Revised)." Large majorities of survey respondents

¹ The Consumer Federation of America is a non-profit association of nearly 300 consumer groups that was established in 1968 to advance the consumer interest through research, advocacy, and education.

indicated that information on fees and expenses, risk profile, asset allocation, and performance history are “absolutely essential” information when making a fund investment decision.

That study’s findings, like the findings of the Commission’s earlier Financial Literacy study, also suggest that investors could benefit from improvements to the shareholder report disclosures to increase comprehension.² As just one example, the survey findings show serious gaps in investors’ understanding of costs that they can incur when owning a fund, one of the topics directly addressed in shareholder report disclosures. According to that survey, significant minorities fail to understand that they could have to pay sales charges when purchasing a fund, and a large majority fails to understand that transactional fees are incurred whenever a fund changes its holdings. Yet the Commission proposal does not include any changes to improve investor comprehension. Instead, with the flimsiest of justifications, it suggests a change in delivery that independent research and the Commission’s own experience suggest will significantly reduce readership of these disclosures.

2) The Commission Provides No Evidence that the Proposed Change is Either Needed or Warranted.

The Commission states in the proposing release that its purpose is “to propose a rule that would permit the website transmission of fund shareholder reports, while maintaining the ability of shareholders who prefer to receive reports in paper to receive reports in that form.” But current rules already allow for electronic delivery where investors prefer to receive disclosures electronically, and many investors today do just that. According to information provided by Broadridge, for example, electronic delivery currently comprises nearly 45 percent of all annual and semi-annual report deliveries for funds held in brokerage accounts, and Broadridge predicts that number will grow to almost 60 percent over the next several years. If Broadridge’s data is reasonably representative, the percentage of investors who today receive electronic delivery of shareholder reports appears to be roughly consistent with the 44-48 percent of investors who indicated on a recent survey that they prefer to receive at least some disclosures electronically.³ The Commission provides no contrary evidence in the proposing release either that current rules prevent investors who prefer to receive disclosures electronically from doing so or that there is a significant misalignment between investors’ preferences and their practices in this regard.

Indeed, the evidence provided by the Commission in support of this proposed change is skimpy at best. First, the Commission suggests that the rule is warranted because “[r]ecent investor testing and Internet usage trends have highlighted that preferences about electronic delivery of information have evolved, and that many investors would prefer enhanced availability of fund information on the Internet.” The data that the Commission cites, however, is largely irrelevant to the proposed rule. Previous research has shown that increased Internet usage does not automatically translate into a willingness to use it for this purpose. Our survey found, for example, while the vast majority of investors surveyed indicated that they use the

² While the rule proposal would increase investors’ access to quarterly reports of fund holdings, it does not include any provisions to improve investors’ comprehension of the disclosures they do receive.

³ Roper, Barbara. “Can the Internet Transform Disclosures for the Better,” Jan. 2014 (Prepared with support from the Financial Industry Regulatory Authority) <http://bit.ly/1CwEbJS>.

Internet either frequently or very frequently, only 54 percent indicated that they were willing to use the Internet to receive reports and documents.⁴

Furthermore, the fact that a majority of investors indicated they would look online if they went in search of a mutual fund shareholder report tells us that many investors are likely to want information about mutual funds to be readily available on the Internet. But it tells us nothing about how they would prefer to receive disclosures for the funds they own. Where the Commission does present relevant information about investor preferences with regard to disclosure delivery, it understates investors' interest in receiving paper disclosures through the mail. If you examine the actual numbers reported in the footnote of the proposing release regarding this issue, just under half of all respondents (49.8 percent) expressed a preference for some form of paper delivery. This includes those who said they preferred paper through the mail with a web address (19.5 percent), paper through the mail exclusively (13.8 percent), and delivery of a print summary through the mail with a complete version available online (16.5 percent). Even if you accept the Commission's interpretation of the data as showing a preference for electronic delivery, it doesn't begin to approach levels of support necessary to justify a default to electronic delivery.

3) The Commission Ignores Research Showing the Distorting Effect of Defaults.

The current apparent reasonably close alignment between the percentage of investors who prefer electronic delivery and those who actually receive disclosures electronically defies conventional wisdom about the distorting effect of defaults. Research has shown that how we set the defaults – opt in versus opt out – has a dramatic effect on the choices individuals will make. Indeed some behavioral science research suggests that defaults have a far stronger influence on the actual choices made than preferences. This suggests that defaults work best when there is a strong preference for one approach over another – in this case a strong preference for paper delivery over electronic delivery or vice versa. But the evidence suggests that investors' preference with regard to delivery of disclosures is far too evenly split to be well served under an approach that relies on defaults.

What then might explain the apparent close correlation between delivery preference and practice under our current approach of defaulting to delivery of paper documents through the mail? One explanation is that industry has a strong financial incentive to move investors to electronic delivery wherever possible. To achieve this goal, some firms impose additional fees on investors who choose to receive paper disclosures to help cover the costs. This creates an incentive for investors who are willing to receive disclosures electronically to take the affirmative step to make the required change. Firms that stop short of offering financial incentives to investors to switch may nonetheless persist in their efforts to encourage investors to choose electronic delivery. In short, industry's incentive to move investors to electronic delivery may help to blunt the distorting effective of a default to paper delivery and create a better alignment between delivery preference and practice.

If the Commission were to permit firms to change the default to electronic delivery, and to do so based solely on negative consent, no such countervailing force would likely exist to blunt the distorting effect of the default. Inertia could be expected to lead a significant

⁴ *Id.*

percentage of investors to move to electronic delivery even where they prefer delivery of paper documents through the mail. Firms would have no incentive to follow up with investors beyond the minimum demanded under the rule to solicit an affirmative response. As a result, the likely outcome of this rule change would be a far greater discrepancy than currently appears to exist between investors' delivery preferences and their actual delivery practices.

4) The Commission Ignores Relevant Data Regarding the Effect of Electronic Delivery on Readership.

The Commission has real experience to draw on in analyzing the likely effect of this proposal. For some time now, Commission rules have allowed proxy voting materials to be provided to mutual fund shareholders under a similar notice and access model. According to statistics from Broadridge, which plays a major role in the distribution of these notices, fewer than one-half of one percent of recipients who receive notices through the mail take steps to read proxy voting materials online. This could be explained either by a lack of interest in the materials, by the ineffectiveness of the notice and access model, or by some combination of these two factors. It is certainly possible that a significantly larger percentage of mutual fund shareholders would read and act on a notice with regard to change in the delivery mechanism for shareholder reports, but it is equally possible that they would not. And yet the Commission fails to acknowledge, let alone address, directly relevant experience that raises significant concerns regarding the effectiveness of this approach. Instead, it builds its entire proposal around the assumption that, if proper and prominent notice is provided, firms could rely on negative consent to switch the delivery mechanism.

5) Minimal Cost Savings Do Not Justify the Proposed Change.

The Commission estimates that fund companies spend in aggregate \$116 million per year to print and mail shareholder reports and that about \$105 million of those costs could be eliminated through adoption of the proposed rule. It further estimates ongoing compliance costs associated with the rule of roughly \$32 million a year. This suggests a net savings of about \$73 million a year if the rule were adopted, spread across 11,957 funds. While the cost savings would not necessarily be shared evenly across funds, the rule would result in average savings on the order of \$6,100 per fund per year. That is a negligible cost reduction that is highly unlikely to be passed on to shareholders and that wouldn't have a noticeable impact on investor costs if it were. Even if there weren't a significant risk that the rule would reduce readership of shareholder reports, the proposed rule could not be justified based on the potential cost savings to investors. Even in the aggregate, such savings are inconsequential in the context of an industry that managed \$18.2 trillion in assets at the end of 2014 on behalf of 90 million shareholders.

6) Other Benefits Do Not Justify the Proposed Change.

The one concrete benefit that the Commission identifies as a result of the rule change is that it would consolidate information on current and historical fund holdings in one place and that it would require information on first and third quarter holdings to be made available to shareholders. But the Commission provides no evidence suggesting that there is a strong demand for this information among investors. While investors surveyed for the Siegle & Gale report did indicate an interest in fund holdings, nothing in the report suggests that a significant percentage of investors want to review changes in fund holdings on a quarter-by-quarter basis.

7) The Proposed Rule Should Be Withdrawn.

The Commission has provided no evidence that the proposed rule is needed to better align delivery methods with investors' delivery preferences. It ignores evidence suggesting that the proposed rule would lead to a greater misalignment between investors' delivery preferences and actual practice. And it similarly ignores evidence suggesting that the rule proposal could significantly reduce the percentage of mutual fund investors who actually read the shareholder reports. Finally, the Commission's stated purpose of enabling investors to choose electronic delivery while preserving the ability of investors to receive documents in paper form is already met by the existing policy. This failure to provide any reasonable justification for the rule is particularly troubling in light of the fact that the Commission's own analysis suggests that any cost savings resulting from the rule would be negligible. Even if those savings were passed along to shareholders, which strikes us as unlikely, they would have no noticeable impact on shareholder returns. For these reasons, we believe the rule proposal should be withdrawn.

8) Conclusion

In 2012 the Commission released a financial literacy report that provided damning evidence that many if not most of the disclosures we currently provide are ineffective in communicating essential information to retail investors. The Commission has, to the best of our knowledge, done nothing since issuing that report to address concerns regarding the timing, format, or readability of those disclosures. Instead, here as in its disclosure review project regarding S-1 and S-K disclosures, the Commission's primary focus appears to be on reducing costs to issuers rather than improving disclosures to investors.

Our opposition to this proposal does not flow from any inherent antagonism to electronic delivery of disclosures. On the contrary, as we discussed in our report on Internet disclosure, we believe that some of these much needed improvements to enhance investor use and understanding of disclosures could be achieved through greater use of the Internet to convey information to investors. But expanding use of the Internet for this purpose will only benefit investors if investors actually receive the information provided and if changes are made to the way we disclose information to capture the benefits of Internet delivery.

This proposal fails to meet this standard for two reasons. First, it does nothing to take advantage of the capabilities of the Internet to improve the presentation of the information contained in the shareholder report, despite evidence from its own survey that such improvements are needed. Second, it adopts an approach that would likely diminish, rather than increase, readership of this information. For these reasons, we urge the Commission to withdraw proposed Rule 30 e-3 and to refocus its attention on measures that would improve, rather than diminish, the quality of disclosure provided to the millions of Americans who own mutual funds.

Respectfully submitted,



Barbara Roper
Director of Investor Protection