Dechert LLP

[redacted]
www.dechert.com

January 4, 2021

VIA ELECTRONIC DELIVERY

Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: Investment Company Act Release No. IC-33963 (File No. S7-09-20) 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

Dear Ms. Countryman:

We appreciate the opportunity to respond to the request by the U.S. Securities and Exchange Commission ("Commission" or "SEC") for comments regarding the above-referenced proposal ("Proposal" or "Proposed Rule").[1] The Proposal provides for sweeping changes to shareholder report and prospectus disclosure for mutual funds and exchange-traded funds ("ETFs," and together, "funds"). We acknowledge the obvious care and thoughtfulness that the Commission and its staff put into the preparation of the Proposal and appreciate the opportunity to offer comments.

Dechert LLP is an international law firm with a wide-ranging financial services practice that serves clients in the United States and abroad. In the United States, we represent a substantial number of U.S. mutual fund complexes, closed-end funds, ETFs, business development companies, fund boards, fund independent directors, fund advisers and fund service providers. In developing these comments, we have drawn on our extensive experience in the financial services industry generally. Although we have discussed certain matters addressed in the Proposal with some of our clients, the comments that follow reflect only the views of a group of attorneys in our financial services practice, and do not necessarily reflect the views of our clients, other members of our financial services group or the firm generally.

---

[1] 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, Investment Company Act Rel. No. IC-33963, 85 FR 70716 (Aug. 5, 2020) ("Proposing Release"), *available at* https://www.sec.gov/rules/proposed/2020/33-10814.pdf.

We applaud the Commission's attention to the needs of retail investors through the modernization of disclosure. Further, we generally support the Commission's efforts through rulemaking to address the needs of retail investors for clear, concise and appropriate disclosure. We believe, however, that certain elements of the Proposed Rule raise concerns. We discuss such concerns and offer proposed enhancements below.

I. COMMENTS ON THE PROPOSED CHANGES TO SHAREHOLDER REPORTS

A. Comments on Material Fund Changes Section

1. Eliminate the Proposed Requirement to Disclose Changes that the Fund Plans to Make in Connection with its Annual Registration Statement Update

The Proposed Rule would require that a fund include a new section in its annual reports briefly describing any material change "that has occurred since the beginning of the reporting period or that the fund plans to make in connection with its annual prospectus update."[2] We recommend that the Commission modify the Proposed Rule to eliminate the proposed requirement that a fund disclose changes that the fund *intends* to make in connection with its registration statement annual update.

We believe that, if funds are required to disclose changes that are anticipated to occur, after the close of the reporting period, there will be an increased administrative burden on funds to monitor and track changes that have not yet been reported to shareholders. It is much easier for funds to implement disclosure processes that are tied to the close of the reporting period.

In addition, we believe that this requirement would result in inconsistent disclosure practices across the industry, as funds and fund service providers may have different internal deadlines for finalizing shareholder report disclosures. For example, two funds in different fund complexes could each change their strategies on the same day after the end of the reporting period; however, due to differing service provider (*e.g.*, administrator or financial printer) practices and deadlines, one fund may include the change in the annual report and one may not. In addition, while a fund may expect to make a material change in connection with its registration statement annual update, it may have a variety of reasons for wanting to wait to disclose such changes, including the expectation or concern that the Commission staff may provide comments on such changes that could result in additional revisions. In this scenario, if the fund were to include disclosure in advance of receiving

---

[2] Proposing Release at 70750.

Commission staff comments, the shareholder report disclosure could become inaccurate or stale. Accordingly, we believe that funds should not be required to disclose changes that occur, or are anticipated to occur, after the end of the reporting period.

Alternatively, the Commission could permit, but not require, the disclosure of changes that the fund anticipates including in its annual registration statement update. To the extent that a fund chooses (or, if the Proposed Rule is adopted as proposed, is required) to include forward-looking disclosure regarding planned changes, we recommend that the fund not be required to disclose such changes again in a future shareholder report that covers the fiscal period during which the change occurred. Requiring a fund to disclose the same change multiple times, at best, would be duplicative and unhelpful to shareholders and, at worst, could create confusion among shareholders regarding the change.

2. Remove Portfolio Manager Changes as an Enumerated "Material Fund Change"

The Proposed Rule would require a fund to disclose changes to the fund's portfolio managers in the proposed "Material Fund Changes" section of the fund's annual report if such changes are deemed to be "material."[3] In our experience, funds generally do not consider portfolio manager changes to be "material" for purposes of determining whether a fund is required to file a post-effective amendment pursuant to rule 485(a) under the Securities Act of 1933 ("Securities Act"). In adopting what is now Item 5(b) of Form N-1A, which requires that a fund "[s]tate the name, title and length of service of the person or persons . . . who are primarily responsible for the day-to-day management of the Fund's portfolio," the SEC stated that updated information regarding a fund's portfolio manager(s) "usually would be set forth in a prospectus supplement or "sticker" that is filed with the Commission and delivered to investors."[4] The MDFP Adopting Release further clarifies that portfolio manager changes may be incorporated in a fund's prospectus in a post-effective amendment filed pursuant to rule 485(b) under the Securities Act and do not require the fund to file a post-effective amendment pursuant to rule 485(a).[5] Consistent with this guidance, funds often disclose portfolio management changes in a registration statement supplement. The inclusion of portfolio management changes on the enumerated list of material changes creates uncertainty regarding the Commission's view of the materiality of portfolio manager changes.

---

3 Proposing Release at 70750.

4 Disclosure of Mutual Fund Performance and Portfolio Managers, Investment Company Act Rel. No. 19382, 58 FR 19050 at 19052 (Apr. 12, 1993) ("MDFP Adopting Release").

5 MDFP Adopting Release at n. 9 ("Under rule 485(b), post-effective amendments that currently are eligible to be filed under paragraph (b) will continue to be so eligible, notwithstanding the addition of, or changes to, information provided in response to [Item 5(b), formerly] Item 5(c).").

Moreover, the materiality of a portfolio manager change may differ depending on the strategies implemented by a fund. For example, investors may consider a change in an individual portfolio manager for a fund that seeks to track an index to be less material than a similar change for an actively managed fund.

We recommend that the Commission remove portfolio manager changes from enumerated "Material Fund Changes" that are required to be disclosed. A fund that determines that a portfolio manager change is material would still be permitted to include such change in its "Material Fund Changes" disclosures because the Proposed Rule permits a fund to "describe other material changes that it would like to disclose to its shareholders." We believe that this approach would provide funds the flexibility to disclose a portfolio manager change in this section if the fund determines it is a material change, but would avoid the inconsistency and confusion created by enumerating portfolio manager changes as "Material Fund Changes."

B. Move Required Disclosure Regarding Liquidity Risk Management Program to Form N-CSR

The Proposed Rule would require a fund to include tailored disclosure regarding liquidity risk and the fund's liquidity risk management program in its shareholder reports.[6] The Proposed Rule would maintain the current timing of liquidity risk management disclosure following a board's review of the fund's liquidity risk management program during the most recent fiscal half-year, but it would change the content of the currently effective disclosure requirement. The Proposed Rule would require a brief summary of the key factors or market events that materially affected the fund's liquidity risk during the reporting period, the key features of the fund's liquidity risk management programs, and the effectiveness of the fund's liquidity risk management program over the last year.[7]

As outlined above, a fund's shareholder report would include a section highlighting liquidity risk; however, the Proposed Rule would not permit a fund to disclose other principal risks of the fund in the fund's shareholder reports. While a fund would be required or permitted to disclose information about changes to principal risks that occurred during the fiscal year, such risk disclosure would appear in the "Material Fund Changes" section and not as part of stand-alone risk disclosure. We believe that this approach places an undue emphasis on liquidity risk. We recommend that the proposed required disclosure regarding liquidity risk management be included in Form N-CSR and be made available on a fund's website instead of being included in a fund's streamlined shareholder report. We believe that including the disclosure in Form N-CSR would make such information available to shareholders who may be interested in such disclosure but avoids over-emphasizing

---

[6] Proposing Release at 70754.

[7] Proposing Release at 70755.

liquidity risk in isolation from a fund's other principal risks. We believe this approach aligns within the Commission's proposed layered approach to disclosure.

Alternatively, the Commission could: (i) permit funds that meet the definition of "In-Kind ETF" or that primarily hold assets that are highly liquid investments pursuant to Rule 22e-4 under the Investment Company Act of 1940 ("1940 Act") to include the proposed required disclosure regarding liquidity risk management in their filings on Form N-CSR; and (ii) require all other funds to include such proposed disclosure in their streamlined shareholder reports. We believe that this approach would avoid placing undue emphasis on liquidity risk for In-Kind ETFs and funds that primarily hold assets that are highly liquid investments.

C. Permit Semi-Annual Shareholder Reports to be Made Available on Demand

Under the Proposed Rule, funds would be required to transmit semi-annual reports to shareholders consistent with current transmittal requirements.[8] The Proposing Release notes that the Commission considered alternative requirements for transmitting semi-annual reports, such as allowing funds to transmit semi-annual reports by filing certain information on Form N-CSR or by updating certain information on a fund website either semi-annually or on a more frequent basis,[9] and the Commission requested comment on alternatives to the proposed semi-annual report transmission requirement. We recommend that funds be permitted to fulfill their semi-annual report transmission obligation by making semi-annual reports available on a fund's website and by filing the semi-annual reports on Form N-CSR, provided that funds would be required to transmit the semi-annual report free of charge to shareholders that request a paper copy. We believe that this approach would be consistent with the Commission's goal of streamlining and layering disclosure and that this approach would result in cost savings that would benefit shareholders and funds.

D. Clarify whether a Trust with Multiple Series May File a Combined Form N-CSR

The Proposed Rule would "restrict funds' annual reports to include only one series of a fund."[10] However, neither the Proposing Release nor the Proposed Rule affirmatively indicate whether funds may continue to file combined filings on Form N-CSR. We request that the Commission confirm that a registrant with multiple series may continue to file a combined Form N-CSR. We

---

8 *See* Proposing Release at 70763.

9 Proposing Release at 70763.

10 Proposing Release at 70730.

believe that requiring each series of a registrant to file a separate Form N-CSR would not provide any benefit to shareholders and would impose unnecessary additional filing costs on funds.

II. COMMENTS ON PROPOSED RULE 498B AND TREATMENT OF ANNUAL PROSPECTUS UPDATES

Proposed Rule 498B would permit a fund to satisfy its prospectus delivery obligations under Section 5(b)(2) of the Securities Act with respect to shareholders who meet the Proposed Rule's definition of "existing shareholders" using the streamlined annual report. A fund would continue to satisfy its prospectus delivery obligation for initial purchases using summary or statutory prospectuses. A fund relying on Proposed Rule 498B would provide an existing shareholder with a streamlined shareholder report, which would include a summary of material fund changes and timely notifications regarding material fund changes as such changes occur. Proposed Rule 498B defines an "existing shareholder" as a shareholder to whom a summary or statutory fund prospectus was sent or given to satisfy any obligation under Section 5(b)(2) of the Securities Act and who has held fund shares continuously since that time. An "existing shareholder" with respect to a money market fund does not need to continuously hold fund shares, but must have continuously maintained (or been a beneficial owner of) an account in that money market fund.[11]

We believe Proposed Rule 498B would essentially create three classes of shareholders within the same fund complex: (1) shareholders who make initial investments in a fund; (2) "existing shareholders" in a non-money market fund who have held fund shares continuously; and (3) "existing shareholders" in a money market fund who may not have held fund shares continuously but have continuously maintained (or been a beneficial owner of) an account in that money market fund. The status of each shareholder under this new paradigm will need to be constantly monitored, and the financial intermediaries and/or third-party vendors used by a fund to perform shareholder materials fulfillment services will likely need to create systems and charge additional fees to the fund for tracking shareholders who hold their shares through financial intermediaries. In light of the expected costs and challenges associated with, among other things, monitoring situations where a shareholder closes out its account and then makes a new purchase in the same fund thereafter, we recommend that the Commission provide a safe harbor under the rule that allows a fund to comply if it has reasonably designed policies and procedures to monitor for existing shareholders.

Second, Proposed Rule 498B would require that "existing shareholders" be provided with notices of certain material changes to the fund within three business days of either the effective date of the fund's post-effective amendment filing or the filing date of the prospectus supplement filing, by

---

[11] Proposing Release at 70775–70777.

first-class mail or other means designed to ensure equally prompt receipt.[12] Proposed Rule 498B defines "material changes" as those topics described under Proposed Item 27A(g) of Form N-1A, which include material changes to a fund's name, investment objectives, principal investments strategies, principal risks, investment adviser(s) and portfolio manager(s), as well as material increases in the fund's ongoing annual fees, transaction fees or maximum account fee.[13]

Proposed Rule 498B does not specify the form of the notice. We note that while most funds currently mail prospectus supplements, or "stickers," to inform shareholders of material fund changes, funds could also satisfy this requirement in other forms. We support the Commission not specifying the form of the notice, however, we believe the specific requirements under Rule 498B regarding the timing of providing such notices within three business days is insufficient and would likely result in additional costs and operational challenges for funds. Due to the large volume of mailings for a fund's entire shareholder base, we recommend that the final rule require funds to deliver notice "as soon as reasonably practicable."

III. COMMENTS ON PROPOSED AMENDMENTS NARROWING SCOPE OF RULE 30e-3

The Proposed Rule seeks to amend the scope of Rule 30e-3 to exclude investment companies registered on Form N-1A (*i.e.*, mutual funds and ETFs). Rule 30e-3, which was adopted by the Commission in 2018, permits investment companies to satisfy their shareholder report delivery requirements by making such reports and other materials available online and providing a notice of availability to shareholders, which is referred to as a "notice and access" option.[14] When the Commission adopted Rule 30e-3, it provided for an extended two-year transition period and stated that the "notice and access" option for transmitting shareholder reports was intended to modernize the manner in which funds deliver periodic information to investors.[15] Most funds have adopted the related disclosures in connection with implementation of Rule 30e-3 and can rely on Rule 30e-3 as of January 1, 2021. We recommend the Commission retain Rule 30e-3.

Under the Proposed Rule, investment companies registered on Form N-1A would instead be required to send tailored annual and semi-annual reports directly to their shareholders, either by mail or, if the shareholder has elected to receive shareholder reports electronically, by e-mail. The Proposed Rule discusses that the proposed amendments to Rule 30e-3 reflect the Commission's

---

12 Proposing Release at 70780.

13 Proposing Release at 70750.

14 *See* Optional Internet Availability of Investment Company Shareholder Reports, Investment Company Act Rel. No. IC-33115, 83 FR 29158 ("Rule 30e-3 Adopting Release").

15 *See* Rule 30e-3 Adopting Release.

belief that the disclosure approach underlying the Proposed Rule represents a more effective means of improving investors' ability to access and digest fund information, and reduces fund expenses in printing and mailing as compared to the printing and mailing of a full shareholder report. However, we believe that investment companies are best positioned to determine the most accessible and cost-effective method of distributing fund documents to their shareholders. A recent survey conducted by the ICI found that Rule 30e-3's notice and access option satisfies most shareholders' disclosure preferences.[16] Furthermore, the Proposed Rule amends the scope of Rule 30e-3 to exclude open-end investment companies, but not other registered management companies. Shareholders of mutual funds and ETFs generally have the same informational needs as shareholders of closed-end funds and other investment companies.

Moreover, a majority of investment companies intend to begin relying on Rule 30e-3 on January 1, 2021. The industry has already invested significant time and resources in preparing for the transition. If the Proposed Rule is adopted, a fund that has communicated to shareholders its intention to rely on Rule 30e-3 would need to invest additional resources to inform its shareholders of this change, which would be a source of confusion for shareholders. The Commission should, at the very least, retain Rule 30e-3 for some longer period to allow these shareholders to realize the benefits of the costs incurred with complying with the Rule.

More broadly, we recommend that the Commission consider making electronic delivery ("e-delivery") of fund documents to shareholders a default, with an option to allow shareholders to opt-in to paper delivery if desired. A recent survey conducted by the ICI, wherein respondents represented 85% of industry mutual fund assets, found that a majority of direct-at-fund accounts with email addresses opted into e-delivery for a number of key fund documents.[17] The survey also found that in the lead-up to compliance with Rule 30e-3, 76% of respondents indicated that less than ½ percent of direct-at-fund shareholders had opted to receive paper shareholder reports.[18] Default e-delivery would align with investor preference, and it would allow funds to ensure cost-effective, prompt delivery of important fund documents to shareholders. Thus, we recommend that the Commission consider making e-delivery of fund documents to shareholders a default while allowing shareholders that prefer paper delivery to opt in.

---

16 *See* Letter to Dalia Blass, Director, Division of Investment Management, US Securities and Exchange Commission from Dorothy M. Donohue, Deputy General Counsel – Securities Regulation, Sarah Holden, Senior Director, Retirement & Investor Research, and Joanne Kane, Senior Director, Operations & Transfer Agency, Investment Company Institute, dated September 10, 2020 ("ICI Survey Letter").

17 *See* ICI Survey Letter.

18 *See* ICI Survey Letter.

IV. COMMENTS ON PROPOSED AMENDMENTS TO PROSPECTUS DISCLOSURE

A. Comments on Presentation of Fee Information in the Prospectus

1. Remove the Proposed Requirement that Funds Present Two Fee Tables in the Prospectus

The Proposed Rule would require funds to present a fee summary and a simplified fee table in the summary prospectus, and would require funds to present a lengthier fee table in the statutory prospectus. The Proposed Rule also would add a requirement that the summary fee table show the cost to investors for each line item, assuming a $10,000 investment.

We think the presentation of two separate and different fee tables in the prospectus will add to the length and complexity of fee disclosures. Further, we believe that requiring the disclosure of the same information twice is redundant and runs counter to the Commission's layered disclosure framework. Ultimately, these proposed changes may lead to investor confusion. We recommend that the Commission retain the current fee table in the summary prospectus.

2. Remove the Proposed Reference to Fee Waivers and Expense Reimbursements as "Temporary" in the Summary Fee Table

The Proposed Rule also would require certain terminology changes. For example, the proposed summary fee table would change the current fee table heading "Shareholder Fees" to "Transaction Fees," and would change the current fee table heading "Annual Fund Operating Expenses" to "Ongoing Annual Fees." The Proposed Rule would permit funds with expense reimbursement or fee waiver arrangements to disclose these arrangements under the caption "Ongoing Annual Fees with Temporary Discount" in the summary fee table.

While we generally support some of the terminology changes in the Proposed Rule, we recommend that the Commission retain the current terminology to describe fee waivers and expense reimbursements. We believe that describing a waiver as "temporary" suggests that an investment adviser has imminent plans to discontinue it and is not consistent with the requirements that waivers have a term that lasts at least one year from the effective date of the prospectus to be disclosed in the prospectus fee table. We also note that we are aware that some advisers have agreed to permanent fee waiver arrangements and the use of "temporary" would not be appropriate under that circumstance.

B. Comments on Acquired Fund Fees and Expenses ("AFFE")

Form N-1A currently requires a fund to disclose as a separate line item in its fee table its pro rata share of the total annual operating expenses paid by other funds in which the acquiring fund invests. The Proposed Rule would allow a fund that invests 10 percent or less of its total assets in acquired funds to disclose AFFE in a footnote rather than as a separate line item in the fee table. Funds investing more than 10 percent of total assets in acquired funds would be required to include this information as a separate line item in the fee table. The AFFE disclosure requirements were intended to "provide investors with a better understanding of the actual costs of investing in a fund that invests in other funds."[19]

We propose that the AFFE line item be removed from the fee table entirely. Instead, we propose that AFFE information be disclosed in a footnote to the fee table or accompanying narrative section. A fund with an AFFE line item in its fee table usually signals a situation where a fund and its adviser have determined that investing in other funds provides the most value and efficiency for shareholders. However, as the Proposing Release noted, "AFFE is a performance expense that is not an operating cost reflected in a fund's statement of operations. Instead, it is an indirect expense paid by the fund to generate performance."[20] In some ways, AFFE is similar to brokerage commissions and other transaction costs, which are not included in a fund's fee table but reflected in a fund's performance. Rather than providing investors with a better understanding of the actual costs of investing in a fund that invests in other funds, the placement of AFFE in the fee table could arguably be misleading to investors as it does not highlight a direct fund operating expense nor does it shed light on whether the investment adviser is managing a fund efficiently. We believe the fee table should include only these direct fund operating expenses, so investors can better analyze and compare the operational aspects of different funds.

If AFFE information is disclosed in a footnote to the fee table or accompanying narrative section, a fund's cost of investing in other funds would continue to be transparent and readily available. Moreover, to assuage any concern that removing AFFE from the fee table would hinder investor protection, we note that two layers of protection already safeguard investors when it comes to excessive or duplicative fees. First, under recently-adopted Rule 12d1-4 under the 1940 Act,[21] acquiring fund investment advisers must find that the acquiring fund's fees and expenses do not

---

[19] Fund of Funds Investments, Investment Company Act Rel. No. IC-27399, 71 FR 36639 at 36645 (Jun. 27, 2006).

[20] Proposing Release at 70793.

[21] Final Rule 12d1-4, 85 FR 73924.

duplicate the fees and expenses of the acquired fund. Second, fund boards are required to make findings under Section 15(c) and Section 36(b) of the 1940 Act[22] that fees are reasonable.

If the Commission retains AFFE as part of the fee table, however, we would support the proposal to allow a fund that invests 10 percent or less of its total assets in acquired funds to disclose AFFE in a footnote, rather than as a separate line item in the fee table.

C. Comments on Principal Risk Disclosure

1. Remove Proposed Requirements to List Risks in Order of Importance and to Prohibit Alphabetical Disclosure of Risks

The Proposed Rule would revise how a fund must disclose in its prospectus the principal risks of investing in the fund. First, funds would be required to disclose principal risks in order of importance, with the most significant risks appearing first. Second, funds would be prohibited from placing risks in alphabetical order. Third, funds would be prohibited from disclosing non-principal risks in the prospectus.

We recommend the removal of the requirement for funds to disclose principal risks in order of importance and the proposal to prohibit funds from listing risks in alphabetical order. Requiring a fund to make an affirmative, forward-looking determination that certain risks are more significant than other risks leaves the fund susceptible to claims from shareholders (even if such claims are without merit). The significance of certain risks to a fund could change over time or could change suddenly and unpredictably due to conditions outside of the fund's control. Risks that the fund placed toward the end of the list could cause losses to a fund, and with the benefit of hindsight, shareholders could sue, claiming that such risk should have been placed at the beginning of the list. Please see further discussion of litigation risks in Section V below.

In addition, many fund complexes include multiple funds in a single prospectus. In such cases, certain risks listed in the statutory prospectus, as required by Item 9 of Form N-1A, apply to certain funds in the prospectus and do not apply to other funds in the prospectus. The proposed requirement to list statutory prospectus risks in order of importance would thus require separate listings of the risks of each fund. This would require lengthier, repetitive disclosures that could confuse investors.

---

[22] Section 15(c) generally requires fund boards annually to approve investment advisory agreements between funds and their advisers (15 U.S. Code § 80a–15). Section 36(b) imposes a fiduciary duty on investment advisers to the funds they advise with respect to compensation and generally prohibits excessive fees (15 U.S. Code § 80a–35).

Ultimately, we believe that the Commission should allow funds to disclose risks in any order, as opposed to requiring risks to be listed in order of importance or not permitting an alphabetical list.

2. Remove Proposed Requirement to Prohibit Disclosure of Non-Principal Risks in the Prospectus

We also oppose the proposed prohibition on funds from disclosing non-principal risks in the prospectus. Non-principal risks, even if only listed in the SAI, could negatively impact a fund's performance. Thus, there is a risk that shareholders could pursue litigation against a fund if a non-principal risk listed in the SAI, rather than in the prospectus, were to cause losses to a fund. Shareholders may allege that by placing such risks in the SAI, a fund would have indicated that such risk was unlikely to come to fruition. We believe that adopting the rule as proposed would expose funds to potentially meritless claims. Please see further discussion of litigation risks in Section V below.

V. COMMENTS ON LITIGATION RISKS POSED BY THE PROPOSAL

A. The Commission Should Make Clear that the Proposed Rule Does Not Alter the "Total Mix of Information" Doctrine

Funds and their boards, officers, and advisers face the threat of litigation under the securities laws based on allegedly misleading statements or omissions in fund disclosures. These suits are largely driven by the plaintiffs' bar, frequently lack merit and typically only serve to distract and drain resources. Although the Proposed Rule does not impose new substantive disclosure requirements in areas that are the frequent focus of litigation, the Proposed Rule should be evaluated to determine whether it could have an unintended consequence of creating additional litigation risk based on the location and ordering of information in a fund disclosure document rather than the substance of the information.

Certain aspects of the Proposed Rule unnecessarily could risk encouraging new, yet meritless, plaintiff arguments based solely on the location and ordering of information within disclosures. In past cases, plaintiffs' counsel have asserted that a disclosure is misleading because certain information about a fund or the risks associated with a fund is "buried" or de-emphasized due to the fact that the information allegedly is not prominently placed in a fund's disclosures.[23] While such arguments are legally flawed, and typically have been rejected by the courts, plaintiffs continue to make such arguments, and funds are forced to expend resources to oppose them. Based on the fact that the Proposed Rule imposes new requirements regarding *the location of* certain

[23] *See, e.g.*, *In re ProShares Tr. Secs. Litig.*, 728 F.3d 96, 106, 108 (2d Cir. 2013); *Emerson v. Mut. Fund Series Tr.*, 393 F. Supp. 3d 220, 245–50 (E.D.N.Y. 2019).

information, the plaintiffs' bar could attempt to use the Proposed Rule to support arguments regarding the location of information in a fund disclosure document, rather than the substance of the disclosure itself. Accordingly, we believe that the Commission should make clear that the Proposed Rule does not alter the "total mix of information" standard for purposes of evaluating securities claims that challenge fund disclosures.[24]

1. "Streamlined" Shareholder Reports

In the event that the Proposed Rule is adopted, there will be potential scenarios where information contained in Form N-CSR, but not in the streamlined shareholder report, could be relevant to the defense of a securities claim.[25] For example, complete portfolio holdings information can be important where plaintiffs claim that they were misled by a fund's disclosures about the types of securities the fund would hold.[26] The disclosure of complete holdings information, and not just a graphical representation of the information, provides the defense that the plaintiffs were aware of all of the fund's holdings, and thus could not have been misled.

Under the proposed structure, we expect plaintiffs to allege that such holdings information was "minimized" or "buried" because it was included only in the online Form N-CSR, and merely summarized in the shareholder report sent to investors. Plaintiffs might attempt to support such an argument by pointing out that detailed information in a fund's SAI may be incorporated by reference into its statutory prospectus, but information omitted from the shareholder report is not.

---

24 The "total mix of information" standard provides that a plaintiff is deemed to be on notice of all of the information in required fund disclosures, including those that are not required to be uniformly delivered to investors but are readily available to them. *E.g.*, *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27, 38 (2011) (The "materiality requirement is satisfied when there is 'a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.'") (quoting *Basic, Inc. v. Levinson*, 485 U.S. 224, 231–32 (1988)) (internal citation omitted). Thus, when determining whether a challenged disclosure could be construed to be misleading, the court must review the disclosure in light of all other required disclosures reasonably available to the investor. With respect to funds, the "total mix of information" includes all of the disclosures issued by the fund and delivered to shareholders, such as the registration statement, Statutory Prospectus, Statement of Additional Information, and shareholder reports. *E.g.*, *In re Morgan Stanley Info. Fund Secs. Litig.*, 592 F.3d 347, 365-66 (2d Cir. 2010) ("When analyzing offering materials for compliance with the securities laws, we review the documents holistically and in their entirety."); *In re ProShares*, 728 F.3d at 104–05; *Emerson*, 393 F. Supp. 3d at 245–50. Shareholders are thus deemed to be on notice of all of the information in these required fund disclosures.

25 *See* Proposing Release at 70749 (proposing "only retaining the graphical representation of holdings, and not a more complete list of fund portfolio holdings" for future annual reports).

26 *See e.g.*, Proposing Release at n. 247 (referencing the 2012 Report on Investor Testing of Fund Annual Reports which notes that 45% of investors deemed a fund's portfolio holdings as "absolutely essential information to any investor").

The Commission should make clear in the adopting release that such a theory is not viable, and that the Proposed Rule does not provide support for such a claim.

2. Disclosure of "Material" Changes

The requirement to disclose "material" changes to a fund also raises potential litigation concerns.[27] For example, fund risk disclosures are often subject to regular review and enhancement based on evolving disclosure practices, market conditions, or major economic events. Such enhancements, while important, might not be deemed "material" and rise to the level of inclusion in the streamlined annual shareholder report. If, however, the disclosure became relevant to a risk that came to fruition, a plaintiff could allege that the risk was minimized because it was not disclosed as a material change to the prospectus in the annual shareholder report.

In addition, there are also unforeseen circumstances that may not be anticipated in the risk disclosures, but are described in other areas of the prospectus, such as tax or redemptions issues. Because the Commission prioritizes certain changes in the summary prospectus over other areas of the full statutory prospectus, a fund may not consider certain other enhancements to be material changes or disclose them as such. However, a situation could arise where a change to clarify a certain tax/accounting position may not be deemed to be a material change at the time, but may become an important factor during a particular event. The Commission should make clear that the Proposed Rule is not intended to affect how courts should assess fund disclosures for purposes of shareholder litigation.

3. Revised Disclosure of Risks

a. Disclosure of "Principal" Risks

A new general instruction requires the disclosure of principal risks and prohibits the inclusion of non-principal risks in response to Item 4 or Item 9.[28] This instruction raises several concerns.

The requirement to disclose principal risks opens the door to litigation claims over what constitutes a "principal risk." The Proposal would add an Instruction to Form N-1A that directs a fund, when determining whether a risk is principal, to consider whether the risk would place more than 10% of the fund's assets at risk or whether it is reasonably likely that the risk would place more than 10% of the fund's assets at risk in the future.[29] If a risk unexpectedly impacted more than 10% of the

---

[27] *See* Proposing Release at 70750; Proposed Item 27A(g) of Form N-1A.

[28] *See* Proposing Release at 70797–70798; Proposed General Instruction C.3.(a) to Form N-1A.

[29] *See* Proposing Release at 70798; Proposed Instruction 1 to Item 9(c) of Form N-1A.

fund's assets, or the fund's NAV changed drastically such that the 10% standard became an unexpectedly low threshold, a plaintiff could allege that the fund misleadingly failed to disclose the risk as a "principal" risk.[30] Second, if a risk that was not disclosed as a "principal" risk comes to pass, a plaintiff might allege that the Fund misleadingly represented that the risk was not material because it was not disclosed as a "principal" risk.

The Commission, at a minimum, should make clear that non-principal risks set forth in an SAI should be considered part of the total mix of information available to investors.

b. Ordering of Risks

The Commission has proposed a new instruction stating that funds should describe principal risks in order of importance.[31] This requirement raises the possibility that if a lower-ranked risk came to pass, a plaintiff could allege that the fund misleadingly represented that the risk was less important than it actually was. That is the very reason that many funds list principal risks alphabetically or by topic. Moreover, to the extent that a fund's portfolio is changing with the market, so too are the priorities of risks associated with those holdings, making the task of accurately ranking principal risks a daily occupation of tracking a constantly moving target.

At a minimum, any amendment requiring rank ordering of risks should be accompanied by Commission guidance stating that such ordering is not intended to alter the total mix of information available or affect how courts evaluate fund disclosures for purposes of shareholder litigation. Thus, for example, the Commission should clarify that a claim that a disclosure is false or misleading because it allegedly did not rank risks in the correct order of importance is not viable.

B. Inadvertent Failure to Comply with Rule 498B

Separate and apart from the disclosure risks identified above, we are also concerned that if there is a failure to comply with certain requirements under Rule 498B, there is a violation of Rule 498A and, thus, a failure to satisfy the prospectus delivery requirements under the Securities Act.

For example, the Proposed Rule would require funds to provide shareholders notice within three business days of either the effective date of the fund's post-effective amendment filing or the filing date of the prospectus supplement filing, by first-class mail or other means designed to ensure

---

30 In addition, the Commission's proposed 10% guidance may present confusion given the general rule of thumb that 5% represents the threshold for materiality.

31 *See* Proposing Release at 70798; Proposed Instruction 2 to Item 4(b)(1) of Form N-1A.

equally prompt receipt.[32] A technical failure to comply with this relatively compressed timeframe (*e.g.*, incorrect or mis-transcribed contact information, or a vendor delay) could result in a violation of the prospectus delivery requirements. Therefore, as noted above, we recommend that the final rule require funds to deliver notice "as soon as reasonably practicable" to provide additional flexibility.

In addition, the Proposed Rule creates a scheme of "new" and "existing" investors with different definitions for existing investors depending on whether the fund in question is a money market fund.[33] The definition of "existing shareholder" could lead to technical errors if a shareholder is misidentified as an "existing" shareholder but is instead a "new" shareholder. Therefore, as noted above, we recommend that the Commission provide for a safe harbor that allows a fund to comply if it has reasonably designed policies and procedures to monitor existing shareholders.

* * * * *

We appreciate the opportunity to comment on the Proposing Release. Please feel free to contact Stephen T. Cohen at [redacted], Megan C. Johnson at [redacted] or Brenden P. Carroll at [redacted] with any questions about this submission.

Very truly yours,

/s/ Dechert LLP

Dechert LLP

---

32 *See* Proposing Release at 70780; Proposed Rule 498B(c)(2).

33 *See Proposing Release* at 70776; Proposed Rule 498B(a)(2) (including a shareholder in a money market fund "who has continuously maintained (or been a beneficial owner of) an account with that fund because a fund prospectus has been sent or given to that shareholder" within the definition of "existing shareholder.").