



January 4, 2021

VIA ELECTRONIC MAIL (rule-comments@sec.gov)

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

RE: 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:

Charles Schwab Investment Management, Inc. (“CSIM”)¹ appreciates the opportunity to comment on the Securities and Exchange Commission’s (the “Commission”) proposed rule and form amendments under the Securities Act of 1933 (the “1933 Act”), the Securities Exchange Act of 1934 (the “1934 Act”) and the Investment Company Act of 1940 (the “1940 Act”) aimed at modernizing the disclosure framework for open-end management investment companies (“funds”) (the “Proposals”).² The Proposals would modernize content and delivery requirements for fund shareholder reports and prospectuses and amend the Commission’s advertising rules.

CSIM strongly supports many aspects of the Proposals and, overall, believes that this is a significant step forward in fund shareholder disclosures. We are encouraged by the Commission’s efforts and commend the Commission for proposing a more user-friendly and

¹ CSIM, a wholly-owned subsidiary of The Charles Schwab Corporation (“Schwab Corporation”), is registered with the Commission and, as of September 30, 2020, serves as investment adviser to over 100 mutual funds, exchange traded funds (“ETFs”), collective investment trusts and separately managed account strategies with over \$550 billion in total assets. CSIM serves clients across the retail, intermediary, and institutional markets. As of September 30, 2020, CSIM is the 3rd largest provider of index mutual funds and the 5th largest provider of ETFs, and advises the 9th largest money market fund complex, with a total of more than \$550 billion in discretionary and non-discretionary assets under management. Schwab Corporation is a leading provider of financial services. Through its operating subsidiaries, the company provides a full range of securities brokerage, banking, money management and financial advisory services to individual investors and independent investment advisers.

² “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” SEC Release Nos. 33-10814; 34-89478; IC-33963, dated August 5, 2020 (“Proposing Release”).

tailored disclosure approach for fund shareholder reports. In addition, we agree that a “layered” disclosure approach, which funds currently use for summary prospectuses, should be extended to annual and semi-annual shareholder reports (collectively “shareholder reports”). The Commission’s proposal to create summary shareholder reports will allow current shareholders to more readily access pertinent information about their fund’s most recent fiscal periods, such as summary disclosures of portfolio investments, key fund statistics, costs, and past performance, in a plain English, easily digested format. We also concur with the Commission’s related proposal to move more in-depth information that appears in current shareholder reports to Form N-CSR available online, delivered free of charge upon request, and filed on a semi-annual basis.

The Investment Company Institute (the “ICI”) and the Securities Industry and Financial Markets Association (“SIFMA”) have each submitted a comment letter on the Proposals (the “ICI Comment Letter” and “SIFMA Comment Letter,” respectively).³ CSIM supports many of the recommendations in the ICI Comment Letter and the SIFMA Comment Letter.

While CSIM strongly supports the stated purpose and many aspects of the Proposals, we do believe there is an opportunity to enhance and clarify certain components. In this comment letter, we will share our perspective and offer some enhancements and modifications on certain portions of the Proposals.

As discussed in greater detail below, CSIM recommends the following:

- *The Summary Prospectus Should Remain the Primary Disclosure Document:* We are concerned that fund shareholders will be confused by the new disclosure regime allowed under Rule 498B, as proposed. We support the creation of the summary shareholder reports but would like to suggest an alternative approach that includes the use of the summary prospectus, captures the benefit of summary shareholder reports, and moves toward the use of electronic delivery as the primary delivery method for regulatory disclosure documents.
- *Funds Should Maintain the Ability to Rely on Rule 30e-3:* The Commission should continue to allow funds the option for notification of availability of shareholder reports under Rule 30e-3, or in the alternative, extend the period for funds to utilize the rule beyond the effective date of the Proposals.
- *The Commission Should Clarify Linkage Requirements for Form N-CSR Information:* We request that the Commission issue guidance on the hyperlinking requirements between (i) the documents contained in Form N-CSR (“N-CSR Information”) and summary shareholder reports and (ii) between N-CSR Information, summary shareholder reports and other posted regulatory documents, should the Proposals be adopted in their current form.

³ Susan Olson, General Counsel, Investment Company Institute and Dorothy Donohue, Deputy General Counsel, Securities Regulation, Investment Company Institute, ICI Comment Letter submitted December 21, 2020; Timothy W. Cameron, Esq., Lindsey Weber Keljo, Esq., Asset Management Group, SIFMA Comment Letter submitted December 22, 2020.

- *The Commission Should Retain Existing Fee Terminology*: The Proposals include new fee terminology that is confusing, inaccurate and in some cases represents drastic changes. CSIM proposes that the Commission retain current and established terminology that we believe more accurately describes fund fees and waivers.

I. The Summary Prospectus is the Best Document for an Investor to Make Informed Decisions to Buy, Redeem or Hold a Fund.

A. Effectiveness of Summary Prospectus

We strongly support the adoption of a summary shareholder report, but we are concerned that reliance on this document by some funds to meet a prospectus delivery obligation to “existing shareholders” (a shareholder that has held shares of a fund continuously) would be highly disruptive to current practices and lead to investor confusion. In addition, we believe this alternative approach will result in unequal fund information disclosure between new and existing shareholders (even shareholders of the same fund), and could lead to potential litigation exposure for a fund and its adviser, without the certainty of reducing a fund’s costs to shareholders.

We see parallels between these Proposals and the Commission’s adoption of Rule 498 (the “Summary Prospectus Rule”) in 2009. As the Commission indicated in the final release of the Summary Prospectus Rule, “the improved disclosure framework is intended to provide investors with information that is easier to use and more readily accessible, while retaining the comprehensive quality of the information.”⁴ The summary prospectus has proven to be easier for investors to use and has allowed funds to provide clear and concise information and in a format that investors can understand. Key information such as investment objectives and strategies, risks, costs, portfolio turnover rate, and performance are provided in the summary prospectus.⁵ The disclosure of this key information has continued to improve as the Division of Investment Management has provided guidance to fund companies regarding clear and concise, user-friendly disclosure.⁶ According to the Commission, as of December 31, 2018, approximately 93% of mutual funds and exchange traded funds (ETFs) use summary prospectuses.⁷ The short, plain English content of the summary prospectus along with a layered delivery approach in which more detailed information is provided online have supported the summary prospectus’ wide-spread adoption.

The Commission’s adoption of a summary shareholder report could in itself revolutionize the disclosure framework. However, we are concerned that, as proposed, the Proposals likely will result in having new and existing shareholders receive different and potentially inconsistent

⁴ “Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies” SEC Release Nos. 33-8998; IC-28584; File No. S7-28-07 January 13, 2009 (“Summary Prospectus Release”), p. 7

⁵ “Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies” (Rule Proposal) SEC Release Nos. 33-8861; IC-28064; File No. S7-28-07 November 21, 2007 (“Summary Prospectus Proposal Release”), p. 11 (Commission highlighted that investor research has indicated investment objectives and strategies, risks, costs, and performance as key information)

⁶ See IM Guidance Update (June 2014) (No. 2014-08)

⁷ Proposing Release, p. 13(footnote 12)

information. For example, if a fund opts to rely on the summary annual shareholder report to meet its prospectus delivery obligations to an existing shareholder, the existing shareholder may not receive a prospectus for several years if he or she is a long-term shareholder. Certain non-material changes to the fund that are reflected in the prospectus, such as introduction of a new asset class or risks that are not considered material but that have been added to the prospectus to reflect the markets, will not be readily apparent to an existing investor that relies solely on the summary annual shareholder report, even if it includes a summary of “material fund changes.” The shareholder would need to reference different layers of disclosure in order to receive the comprehensive information that an initial investor would automatically be provided via the summary or statutory prospectus concurrent with the purchase of the fund. This information is critical to an investor in making an informed decision whether to buy, redeem or continue to hold the fund shares. As the Commission has indicated in the Proposals, the “proposed shareholder reports would contain similar information to some of those prospectus disclosures...”⁸ We emphasize that information would be similar but not the same.

The new framework may also lead to inconsistent disclosure at certain times such as when there is a decrease in fund fees and expenses. As proposed, existing shareholders may be unaware of fee and expense decreases because they are disclosed in the prospectus, but such decreases are not required to be disclosed in the summary annual shareholder report. For certain types of funds like passive equity funds this information could be very important.⁹ We also believe that some of the provisions of the Proposals would impact the Commission’s goal of investor protection. Fund investors should be able to easily compare “like” information across funds and fund complexes to make an informed investment decision.

We are further concerned that a fund shareholder could experience any one of several possible disclosure documents, depending on the investor’s individual circumstances. A shareholder of a fund that has not adopted Rule 498B would receive the summary shareholder report(s) as well as an annual prospectus. A shareholder of a fund that has adopted Rule 498B could either receive just summary shareholder report(s), if he or she is an “existing” shareholder, or could receive the annual prospectus as well if he or she has traded in and out of the fund over the year, as is common with certain types of mutual funds specifically intended for that purpose and with ETFs. As such, we are worried about existing shareholders truly understanding the mechanics of the proposed disclosure regime and understanding the additional steps needed to access the equivalent level of information as new investors. We believe this complex delivery model creates the potential for significant shareholder confusion, inundation with and duplication of disclosure documents.

Finally, we note that if funds are at all unsure about the potential litigation that could arise, funds will be reluctant to opt into Rule 498B, even if it may lead to some cost savings for funds that no longer have to deliver the prospectus annually to some shareholders. Providing shareholders with certain key information, with the option to review more detailed information in other documents incorporated by reference has proven to be effective, but could possibly result in meritless shareholder lawsuits and anti-fraud claims for failure to adequately disclose key facts about a fund that would generally appear in a fund prospectus. The Commission addressed

⁸ Proposing Release at p. 230.

⁹ *Id* at 132 (footnote 272).

some of these liability concerns in the Summary Prospectus Rule by allowing funds to incorporate the full statutory prospectus by reference, which is not addressed in Rule 498B. Further layering without incorporation by reference could provide a runway for disclosure litigation.

B. Alternate Approach

Again, CSIM is in support of the Commission's goal to design a disclosure approach that tailors the information received by fund shareholders to help them "better assess and monitor their fund investments and make informed investment decisions."¹⁰ However, we would like to offer an approach that combines existing and proposed rules. The following is an outline of our alternate approach:

1. Electronic Delivery as a Default. CSIM proposes that electronic delivery become the default option for delivery of shareholder reports and prospectuses without obligating a shareholder to affirmatively "opt-in" to electronic delivery as required by current Commission guidance. The use of electronic delivery further reduces the use of paper, reduces expense for shareholders and harnesses the benefits of the internet and other technologies which is consistent with other Commission initiatives.¹¹ An option should remain to allow shareholders to request one-time delivery of paper documents and require shareholders to "opt-in" for paper delivery on an ongoing basis. The Commission has acknowledged that many investors enjoy having documents delivered electronically and has indicated that "electronic delivery and website availability of disclosures are methods that have the potential to significantly improve the communication of information to investors."¹² We believe that this potential can be realized in the combination of our approach and the Proposals.

2. Material Fund Changes. In the Proposals, the Commission discussed the importance of current shareholders continuing to be informed in a timely manner regarding material changes to a fund. We would propose that funds continue to deliver prospectus supplements as their mechanism to convey material changes during the year as opposed to separate notice of material fund change documents that are being proposed for existing shareholders under the Proposals. We would support the inclusion of a section entitled "Material Fund Changes" in the summary prospectus that incorporates material changes since a fund's last prospectus update and as previously suggested, the summary prospectus continues to be the primary disclosure document for fund information. This primary document would be the repository for material fund changes.

If, as proposed, material fund changes were to be included in the summary shareholder reports, we would encourage the Commission to limit material fund changes presented in shareholder reports to those changes that occurred during the applicable fiscal period. The disclosure should not include any forward-looking changes that the fund plans to make in

¹⁰ *Id.* at 38

¹¹ See Optional Internet Availability of Investment Company Shareholder Reports Final Rule Release, Release Nos. 33-10506, 34-83380, IC-331159, File No. S7-8-15 (June 5, 2018) ("Rule 30e-3 Final Rule") p. 30

¹² *Id.* at 100

connection with its annual prospectus update.¹³ Fund changes are often uncertain and unpredictable. Shareholders may become confused if changes forecasted or previewed in a shareholder report do not come to fruition. Further, because shareholder reports are predominantly backwards looking, previewing material changes may lead shareholders to inadvertently and erroneously assume that the anticipated changes were in effect during the fiscal period.

3. Eliminate Delivery Requirement for Semi-Annual Shareholder Report. We propose that funds continue to use Rule 30e-3, which we explain in more detail below. Additionally, we suggest that funds deliver summary annual shareholder reports but not be required to deliver the unaudited summary semi-annual shareholder reports.¹⁴ The summary semi-annual shareholder reports would be required to be posted on the fund's website. Shareholders would be informed as to how they may access the summary semi-annual shareholder reports in the preceding summary annual shareholder report and/or prospectus. The Commission has suggested that Rule 498B would reduce the cost of delivering shareholder reports for funds that do not rely on Rule 30e-3 "by replacing the cost of sending current annual and semi-annual reports with the smaller cost of sending concise reports to those shareholders."¹⁵ Under our alternate approach, summary annual shareholder reports will be delivered as well as the summary prospectus but we believe there could be similar cost reduction as contemplated under 498B for all funds through reliance on electronic delivery and the elimination of the delivery of semi-annual reports. Funds would continue to benefit from the cost savings from the delivery of a concise summary annual shareholder report or a notice of availability, if Rule 30e-3 is retained.

The alternate approach that we recommend above mitigates shareholder confusion and limits the need for drastic and disruptive disclosure delivery changes while achieving the Commission's investor protection objective of disclosing key information in a concise manner.

II. Rule 30e-3

The Proposals would amend the scope of Rule 30e-3 to exclude mutual funds and ETFs. We strongly support the retention of Rule 30e-3 and suggest that the Commission (i) preserve Rule 30e-3 as an option available to open-end investment companies regardless of whether a fund elects to avail itself of optional 498B; or (ii) extend the period for the use of Rule 30e-3 for a period of time after the effective date of a final shareholder disclosure reform rule to allow time for transition to a new disclosure framework.

With the effective date for Rule 30e-3 set for January 1, 2021, many open-end investment companies have invested assets into structuring systems and processes to implement requirements of the rule, and yet have not been able to gather data to validate that it will

¹³ CSIM supports Rule 498B's website availability, document readability and notice features and do not address this portion of the rule, which seem to be similar to summary prospectus requirements. (See Proposed rule 498B(d)(2)(i) and (ii)).

¹⁴ CSIM strongly supports the ICI's recommendation to permit funds to post semi-annual shareholder reports online. (Please see ICI Comment Letter, page 13)

¹⁵ Proposing Release at p.384

materially reduce expenses related to the printing and mailing of shareholder reports.¹⁶ Given that funds have not yet been able to rely on Rule 30e-3, funds are unsure of the cost savings to be gained by reliance on Rule 30e-3. Retaining Rule 30e-3, at least for a period of time following adoption of the Proposals, could be a reasonable approach, allowing mutual funds and ETFs the opportunity to determine any cost savings. Funds have also not had the opportunity to gauge investor satisfaction with the notice and access shareholder report delivery model, which most shareholders have appeared to embrace, given the relatively low numbers of shareholders that have elected to receive paper delivery of shareholder reports.

III. Links on a Fund's Website

The Proposals provide that funds must post N-CSR Information online and include a hyperlink specific enough to lead investors directly to a specific item or a central site with prominent links to the referenced information. The Commission further states that a fund could group N-CSR Information on its website if such website clearly distinguishes the different types of materials and/or each series (as applicable) and provides a means of easily locating the relevant information. If the Proposals are adopted as proposed, we request that the Commission clarify expectations on document linkage requirements between N-CSR Information and summary shareholder reports and between other posted regulatory documents.

The Summary Prospectus Rule allows an investor to move back and forth between related sections of the summary prospectus, and the statutory prospectus and statement of additional information (SAI), in a single mouse click or through a table of contents of the prospectus or SAI in two mouse clicks. Funds have spent time and money creating these one and two mouse click linkages. We suggest that funds be allowed to build off this established framework. We request that the Commission further clarify whether the linkage requirements between N-CSR Information, summary shareholder reports and other posted regulatory documents will be similar to those of the Summary Prospectus Rule and that such a linkage regime would meet the Commission's expectations.¹⁷

IV. New Simplified Fee Terminology

The Proposals recommend changes in certain terminology that funds use to describe fund fees, expenses and waivers. We commend the attempt by the Commission to encourage funds to use "plain" language to describe fees, expenses and waivers disclosed in the prospectus. Fee terminology is not often self-explanatory except to industry professionals. However, it should be noted that some fee terms have been around for many years and have become accepted vernacular for fund investors and the financial professionals that serve them. Because of this familiarity, the Commission's proposed terminologies raise concerns regarding potential investor confusion.

¹⁶ Beginning on January 1, 2021, funds may rely on Investment Company Act Rule 30e-3, which permits the fund to deliver a paper notice in the US mail informing shareholders that a shareholder report is available at an identified website. See Rule 30e-3 Final Rule at pages 76-78 (regarding the effective date and transition period and related conditions) (June 5, 2018)

¹⁷ Summary Prospectus Release p.88-90.

We are also concerned about whether the proposed new fee terms are completely accurate. For example, the term “temporary discounts” is being proposed to describe fee waivers and reimbursements. “Temporary” suggests that a fund will terminate its waivers, and yet funds do not always terminate waivers and such waivers often remain in place indefinitely. Similarly, changing “distribution and services (12b-1) fees” to “selling fees” does not completely reflect uses of these fees, which can include use of fund assets for shareholder services as well as distribution. Investors may also incorrectly associate “selling fees” with sales loads. The Proposals’ introduction of “early exit fees” does not correlate with most funds’ prospectus descriptions of associated “redemption” transactions. Transactions in fund shares are often described in terms of purchases, *redemptions* and exchanges. There are other new proposed terminologies that similarly may not be completely accurate.

While we support efforts to improve understandability of fund information, it is unclear as to whether the new simplified fee nomenclature achieves the Commission’s goal of “ease of understanding” of these commonly used fund fee terms. We propose that the Commission retain existing fee terminology, particularly the terms “distribution and services (12b-1) fee”, “redemption fee” and “fee waiver.”

V. Conclusion

CSIM appreciates the opportunity to comment on the Proposals. We reiterate our strong support to modernize the disclosure framework for open-end investment companies.¹⁸ However, given that some of the disclosure and delivery modifications could confuse investors and impact cost to funds and ultimately investors, CSIM believes the Commission should consider amending its approach as outlined in our letter. CSIM nevertheless believes the Commission should continue to seek to provide key information in a concise manner.

If the Commission or its Staff would like more information on any topics we have covered in this letter, we would be pleased to meet with the staff at your convenience.

Sincerely,



Jonathan de St. Paer
President
Charles Schwab Investment Management, Inc.

¹⁸ CSIM has also consulted with Charles Schwab & Co., Inc. (“CS&Co.”), one of its affiliated broker-dealers, on the Proposals. While also generally supportive of the modernization of the disclosure framework, CS&Co. has raised some concerns about the transparency of fee and expense information to investors under the Proposals, as well as the amendments to the fund advertising rules, particularly how they mesh with the existing mutual fund advertising content standards overseen by FINRA. Many investors use financial intermediary websites and other intermediary tools to compare funds and fund families prior to investing. These websites are typically populated through a third-party vendor data feed and are structured in a way that provides key information in a standard format intended to allow an investor to make a sound comparison across several key data points. Removing some of the information from the fee table and adding to footnotes could provide less granularity of disclosure to investors, and ultimately, lead to more investor confusion. We urge the Commission to consider these matters in any final rule adopted by the Commission

cc:

Honorable Elad L. Roisman, Acting Chair, U.S. Securities and Exchange Commission

Honorable Hester M. Peirce, Commissioner, U.S. Securities and Exchange Commission

Honorable Allison Herren Lee, Commissioner, U.S. Securities and Exchange Commission

Honorable Caroline A. Crenshaw, Commissioner, U.S. Securities and Exchange Commission

Ms. Dalia Blass, Director, Division of Investment Management, U.S. Securities and Exchange Commission