

June 13, 2018

SEC Adopts Rule Providing Modernized Delivery Option for Fund Shareholder Reports and Seeks Comments on Improving Fund Disclosure and Certain Fees of Intermediaries

SEC Allows Optional “Notice and Access” Method for the Delivery of Fund Shareholder Reports and Invites Comments on Improving Fund Disclosure and on Fees That Intermediaries Charge for Delivering Fund Reports

SUMMARY

On June 5, 2018, the Securities and Exchange Commission (“SEC”) announced adoption of new rule 30e-3 under the Investment Company Act of 1940 (“Rule 30e-3”), which creates an optional “notice and access” method for delivering shareholder reports.¹ Rule 30e-3 was passed on a 4-1 vote. The rule allows mutual funds and certain other registered investment companies (collectively, “funds”) to deliver shareholder reports by making them publicly accessible on a website, free of charge, and sending investors paper notices of the reports’ availability by mail.² Investors will still have the option to receive the full reports in paper form without charge.

Also on June 5, 2018, the SEC invited public comment on the following:

- Additional ways to improve fund disclosure by modernizing the design, delivery and content of fund information, including how to make better use of modern technology to provide more interactive and personalized disclosure.³
- The framework for certain processing fees that broker-dealers and other intermediaries charge funds for delivering shareholder reports and other materials to investors.⁴

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The adoption of Rule 30e-3 and the requests for comments on the above two topics are part of a long-term project, led by the SEC's Division of Investment Management, to modernize fund disclosures for the benefit of investors.

RULE 30e-3

Rule 30e-3 was first proposed in 2015 and has since been the subject of robust commentary from a broad range of interested parties.⁵ Final Rule 30e-3 reflects a number of modifications from the initially proposed version, including an extended transition period and the optional inclusion of information from the shareholder report in the paper notice. The rule also addresses numerous technical issues, including issues relating to fund complexes and intermediaries.

The purpose of Rule 30e-3 is to allow funds to take advantage of modern technology in meeting their periodic disclosure obligations to shareholders. Shareholders who prefer paper may either elect to receive all future reports in paper form or request to receive particular reports in paper form on an *ad hoc* basis. All notices provided to shareholders under the new rule are required to explain how shareholders may access the relevant reports online and how shareholders may request paper copies should they so choose. The conditions of Rule 30e-3 include:

- The shareholder report and the fund's most recent prior report must be publicly accessible, free of charge, on a website specified in the paper notice discussed below.⁶
- The quarterly holdings for the last fiscal year must be publicly accessible on the website.⁷
- Funds must satisfy conditions designed to ensure accessibility of reports, including a requirement that reports be in a format convenient for both reading online and printing on paper and a requirement that the website relied on not be the address of the SEC's electronic filing system.⁸
- Within 70 days after the close of the period for which the report is being made, shareholders must be sent a paper notice of the availability of each report. The notice must include the website address where the shareholder report and other required and optional information is posted, in addition to instructions for requesting a free paper copy or electing paper transmission in the future.⁹
- The paper notice may include certain additional information, including (1) instructions for electing to receive shareholder reports or other documents by electronic delivery¹⁰ and (2) additional content from the shareholder report. Additional content from the shareholder report may include, for example, graphical representations of holdings, performance information, a brief statement of the fund's investment objectives and strategies and the name and title of the fund's portfolio manager.¹¹
- Funds must send a paper copy of relevant materials, free of charge, within three business days after a request for a paper copy is received.¹²
- Shareholders must be able to elect to receive all future reports in paper form by calling a toll-free telephone number or otherwise notifying the fund intermediary.¹³
- There is an extended transition period, which provides that the earliest date on which notices under the new rule may be transmitted to investors in lieu of paper reports is January 1, 2021. If a fund seeks to rely on the rule before January 1, 2022, the fund will generally be required to provide notice to shareholders in each prospectus, summary prospectus and annual and semi-annual report sent to investors for a two-year period before relying on the rule.¹⁴

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SEC Chairman Jay Clayton noted that “[t]he new rule significantly modernizes delivery options for fund information while preserving the right of fund investors to receive information in paper form as they do today.”¹⁵ In his public statement following announcement of the adoption of Rule 30e-3, Chairman Clayton highlighted benefits such as improved search functions, the ability to hyperlink and to move quickly within a document, and the option to more conveniently save a document for future reference as tools that are unavailable with paper documents.¹⁶ The SEC also expects the new rule to help funds save on printing and mailing costs, which are ultimately passed on to fund investors.¹⁷ The SEC’s Division of Economic and Risk Analysis estimates the collective cost savings for investors to be almost \$1.5 billion over the next decade.¹⁸ The adopting release also summarizes comments from the public that note the potential environmental benefits associated with the new rule.¹⁹

While both Commissioner Kara M. Stein and Commissioner Robert J. Jackson Jr., in their public statements, outline various concerns regarding the adoption of the new rule, ultimately, Commissioner Jackson cast the lone dissenting vote.²⁰ In his dissent, Commissioner Jackson stated that Rule 30e-3 “reverses our default rule, switching the burden from fund management to individual investors,” which is a “choice contrary to everything we know about how individual investors and funds actually behave.”²¹ While Commissioner Stein supported the adoption of the rule, she expressed concern about whether reversing the default rule will make it too difficult for investors desiring paper reports to obtain them. She noted that after Rule 30e-3 goes into effect the SEC staff will review and report back to the SEC on the implementation of the rule. Accordingly, in her view, the rule should be viewed “as a pilot program” that may require adjustments depending on how it is implemented.²² After the rule goes into effect, SEC staff will analyze the ease with which investors can elect their delivery preferences.

The manner in which Rule 30e-3 was adopted has also been subject to some criticism, as the SEC struck the matter from the agenda of an open meeting on June 5 at the last minute, announcing that it had already voted on the proposal the day before.

REQUESTS FOR COMMENT

As part of the ongoing project to modernize the design, delivery and content of fund disclosures for the benefit of investors, the SEC is seeking public comment on additional ways to improve fund disclosure and on the framework for certain processing fees that intermediaries charge funds for delivering reports.

Enhancing Fund Disclosure

The SEC is seeking input on how to enhance fund disclosures such that information is presented in a way that works best for individual investors. The request reviews the current disclosure regime applicable to funds, and then asks for responses to 111 specific questions. The SEC solicits feedback specifically from individual retail investors, academics, literary and design experts, market observers, and fund advisers and boards of directors on the design, delivery and content of a range of fund disclosures, including

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shareholder reports, prospectuses and advertising materials.²³ The request also seeks feedback on investor preferences for means of delivery and how best to leverage modern technology to make disclosure more interactive and personalized.²⁴ Among the specific questions asked are whether the SEC should follow the example of certain foreign regulators and: (i) require “point of sale” disclosure;²⁵ (ii) impose page limits on the summary prospectus;²⁶ or (iii) require quantification of a fund’s risk.²⁷

Other specific questions asked by the SEC include:

- whether it should continue to require delivery by funds of paper copies of their prospectuses or summary prospectuses unless an investor has specifically chosen to receive these documents electronically;²⁸
- whether it should address the length and complexity of principal strategies and principal risks disclosure in summary prospectuses (the release notes the SEC staff’s observation that principal strategies disclosures vary in length from under 100 words to over 5,000 words, and that principal risks disclosures vary from less than 200 words to over 7,000 words);²⁹
- whether risks should be required to be listed in order of importance and whether one or more quantitative measures of risk (such as historic volatility, standard deviation or Sharpe ratio) should be disclosed;³⁰
- whether there should be disclosure of soft dollar information, transaction costs or external costs such as costs of an investor’s financial professionals; and³¹
- whether there should be additional disclosure about funds’ disclosed benchmarks, including how the benchmark was selected.³²

To encourage individual investors to comment, the request includes a short Feedback Flier that can be submitted online.³³

Processing Fees Charged by Intermediaries

The adoption of Rule 30e-3 calls into question the appropriateness of the overall framework under New York Stock Exchange and self-regulatory organization rules for processing fees that broker-dealers and other intermediaries charge funds to deliver reports. The current framework provides for increased fees to brokers and vendors for sending reports electronically, since intermediaries have had to track which shareholders do not want to receive paper copies. The SEC is seeking public comment and additional data on the current framework to better understand the potential effects on funds and their investors. The topics on which the SEC is requesting comments include:

- the assessment of processing fees;³⁴
- the transparency of processing fees;³⁵
- remittances received by financial intermediaries for delivery of fund documents;³⁶
- whether the structure and level of processing fees should be set by another entity; and³⁷
- the appropriateness of processing fees where intermediaries are separately paid shareholder servicing fees out of fund assets.³⁸

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The SEC requests that any feedback on either of the two requests for comment be submitted by October 31, 2018.³⁹

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ENDNOTES

- ¹ *Press Release: SEC Modernizes the Delivery of Fund Reports and Seeks Public Feedback on Improving Fund Disclosure*, SEC press release 2018-103 (June 5, 2018), available at <https://www.sec.gov/news/press-release/2018-103>.
- ² *Final Rule: Optional Internet Availability of Investment Company Shareholder Reports*, SEC Rel. Nos. 33-10506, 34-83380, IC-33115 (June 5, 2018), available at <https://www.sec.gov/rules/final/2018/33-10506.pdf>.
- ³ *Request for Comment on Fund Retail Investor Experience and Disclosure*, SEC Rel. Nos. 33-10503, 34-83376, IC-33113 (June 5, 2018), available at <https://www.sec.gov/rules/other/2018/33-10503.pdf>.
- ⁴ *Request for Comments on the Processing Fees Charged by Intermediaries for Distributing Materials Other Than Proxy Materials to Fund Investors*, SEC Rel. Nos. 33-10505, 34-83379, IC-33114 (June 5, 2018), available at <https://www.sec.gov/rules/other/2018/33-10505.pdf>.
- ⁵ *Proposed Rule: Investment Company Reporting Modernization*, SEC Rel. Nos. 33-9776, 34-75002, IC-31610 (May 20, 2015), available at <https://www.sec.gov/rules/proposed/2015/33-9776.pdf>. The proposed rule was discussed in *SEC Proposes Rules to Modify Reporting Regime for Registered Investment Companies and Investment Advisers*, Sullivan & Cromwell LLP (May 26, 2015), available at <https://www.sullcrom.com/sec-proposes-rules-to-modify-reporting-regime-for-registered-investment-companies-and-investment-advisers>. Groups such as the American Forest & Paper Association, the Envelope Manufacturers Association and the National Association of Letter Carriers submitted comments in opposition to the proposed rule, while others such as the Investment Company Institute, various fund companies and Environmental Paper Network supported it.
- ⁶ *Final Rule* at 189.
- ⁷ *Id.* at 189-90.
- ⁸ *Id.* at 190-91.
- ⁹ *Id.* at 191-93. The notice may accompany certain other materials, including a current summary prospectus, statutory prospectus, statement of additional information or Notice of Internet Availability of Proxy Materials. *Id.* at 194.
- ¹⁰ Electronic delivery refers to documents or website links thereto being emailed directly to an investor's individual email address. *Id.* at 20.
- ¹¹ *Id.* at 59, 193. Funds that choose to transmit notices with additional information from the shareholder report must file such notices as part of their reports on Form N-CSR. *Id.* at 60, 207.
- ¹² *Id.* at 195.
- ¹³ *Id.* at 191, 193. A shareholder's election for paper reports would apply on an investor account level, rather than a fund position level. *Id.* at 74, 195.
- ¹⁴ *Id.* at 187-88, 196-97, 198-207. The SEC explains that funds that begin providing notice at the start of 2019 will complete the two-year notice period, and may begin relying on the rule, on January 1, 2021. In addition, funds that are newly offering their shares during the period January 1, 2019 through December 31, 2020 may rely on the rule starting January 1, 2021, if they provide notice to shareholders starting at the time of their first public offering. Funds that are newly offered on January 1, 2021 and thereafter may rely on the rule immediately without providing any advance notice through required statements. All other funds may not rely on the rule until they have completed a full two-year notice period or until January 1, 2022, whichever comes first. *Id.* at 76-78.

ENDNOTES (CONTINUED)

- 15 *Press Release.*
- 16 Jay Clayton, Chairman, SEC, *Statement on Investment Company Design, Delivery and Disclosures Rulemaking Package* (June 5, 2018), available at <https://www.sec.gov/news/public-statement/statement-clayton-060518>.
- 17 *Final Rule* at 102.
- 18 *Id.* at 103.
- 19 *Id.* at 25.
- 20 Robert J. Jackson Jr., Commissioner, SEC, *Statement on Investment Company Disclosure* (June 6, 2018), available at <https://www.sec.gov/news/public-statement/statement-jackson-060618>; Kara M. Stein, Commissioner, SEC, *Statement on Final Rule on the Optional Internet Availability of Investment Company Shareholder Reports, Request for Comment on the Investor Experience, and Request for Comment on Intermediary Fees* (June 5, 2018), available at <https://www.sec.gov/news/public-statement/statement-stein-060518>.
- 21 *Statement on Investment Company Disclosure.*
- 22 *Statement on Final Rule on the Optional Internet Availability of Investment Company Shareholder Reports, Request for Comment on the Investor Experience, and Request for Comment on Intermediary Fees.*
- 23 *Request for Comment on Fund Retail Investor Experience* at 5, 7-11.
- 24 *Id.* at 13-22, 26-27, 30, 32-36, 56.
- 25 *Id.* at 15-16. For example, the Ontario Securities Commission requires point of sale disclosure for mutual funds: http://www.osc.gov.on.ca/en/InvestmentFunds_point-of-sale_index.htm.
- 26 *Id.* at 29-30. For example, Canada's Fund Facts document cannot exceed four pages, and the European Union's Key Investor Information Document cannot exceed two pages.
- 27 *Id.* at 42-43. Both the Fund Facts document required by Canadian securities regulators and the Key Investor Information Document required by the European Union require funds to quantify their level of risk.
- 28 *Id.* at 20.
- 29 *Id.* at 37-43.
- 30 *Id.* at 43.
- 31 *Id.* at 46-48.
- 32 *Id.* at 50.
- 33 *Id.* at Appendix B; *Investor Experience Feedback Form*, available at <https://www.sec.gov/rules/proposed/2018/34-83063.html>.
- 34 *Request for Comments on the Processing Fees* at 12-13, 17-20.
- 35 *Id.* at 13.
- 36 *Id.* at 13, 15-17.
- 37 *Id.* at 15.
- 38 *Id.* at 20-22.
- 39 *Request for Comment on Fund Retail Investor Experience* at 1; *Request for Comments on the Processing Fees* at 1.

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