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Mutual Funds

Industry Showers Love on SEC Proposal for Shorter Disclosure Statements

By John Morgan

A proposal by the Securities and Exchange Commission to shorten mutual fund disclosure statements is meeting widespread support, and a new rule could take effect by 2009, if not sooner.

Currently, mutual fund companies are required to send investors a full fund prospectus, which is often 200 pages or longer. While the full prospectus contains valuable information, the sheer enormity is so overwhelming that most investors flip through the first few pages before setting it aside, or simply toss the whole thing in the trash.

“When your customers routinely throw your product away, you’ve got a problem,” said SEC Chairman Christopher Cox. “There can be many reasons that our customers might be dissatisfied, but the most obvious is that investors are busy people. Wading through dense legalese isn’t their day job, and they ordinarily just don’t have time for it. If time is money, then poorly written disclosure documents are wasting one of the investor’s most important assets.”

Bulk mailings send investors 10 times the amount of paper required by law, obscure pertinent investment information, and appear to be in contrast with the SEC and industry movement to simplify disclosure and fund

comparison, said a report by Andover, Mass.-based consulting firm NewRiver.

The SEC’s proposal still requires companies to create a full prospectus and mail it to investors upon request, but it’s no longer a requirement to send the full version to everyone.

- written in plain English.

“Like the risk/return summary that is already required at the front of every mutual fund prospectus, this summary would include a fund’s investment objectives and its strategies, risks, and costs,” Cox said. “It also would include

The short prospectus would refer investors to the long version, available on the web, or by mail upon request. The web version will use layered disclosure and "deep linking" to allow investors to get more specific information by clicking on certain links, said Len Driscoll, VP of product marketing at NewRiver.



—LEN DRISCOLL, VP OF PRODUCT MARKETING

“By pairing the summary prospectus with easy access to the long-form prospectus, the SEC’s proposal will increase the chances that investors will actually use funds’ key investment information, with no loss of the detailed disclosure some market participants need,” said Paul Schott Stevens, president and CEO of the Investment Company Institute.

This change should save the industry hundreds of millions of dollars in printing and postage fees, not to mention millions of trees, according to a Forrester Research study. In place of the full prospectus, investors will get a brief one- to four-page summary of the longer prospectus that contains key facts - such as the fund’s investment objectives, fees, risks, and performance

brief information regarding top 10 portfolio holdings, investment advisers and portfolio managers, purchase and sale procedures and tax consequences, and how the people who sell the fund are paid.”

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“Using the Internet, investors could drill down from the summary prospectus to more detailed information, depending on their interests and needs,” Cox said.

"Investors are best served when performance data is put in context, and prospective shareholders can easily determine whether the fund has consistently beaten its performance benchmark," said Morningstar analyst Laura Pavlenko Lutton in a letter to the SEC. "It shouldn't be a burden for asset managers to provide this performance comparison as they typically do so in funds' annual reports." Comments on the SEC's proposed rule have been overwhelmingly supportive. "The feedback we're getting has been very, very favorable," Driscoll said.

The leading concerns about the proposal have to do with liability and the expense of sending out quarterly updates by mail, instead of annually. The quarterly updates are intended to

be a benefit to investors and not a burden to fund companies, the SEC said. Updating an online prospectus quarterly is far more cost effective than mailing a full prospectus every three months.

NewRiver said the print-on-demand requirement will be easier on printers and eliminate the need for warehouses full of mutual fund prospectuses, supplements, and other compliance disclosure documents.

"With the advent of the SEC's summary prospectus rule, firms can better meet the needs of their customers by delivering prospectuses in the form and length they desire and more importantly realize even greater cost savings by shifting to a digital, print on-demand model," said Russell Planitzer, NewRiver's president and CEO. "For those clients who still prefer to receive paper-based communications, NewRiver Virtual Document Warehouse enables them to combine both the trade confirm and the prospectus in a single mailing, which will improve the overall investor experience, reduce waste and eliminate unnecessary costs and fulfillment."

—RUSSELL PLANITZER, PRESIDENT AND CEO



NewRiver has come up with a Virtual Document Warehouse to store the traditional prospectus inventory online and allow users to access and print information themselves, as well as print and mail the updated printed versions to those investors who request it.

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Cox is anticipating a final rule from the Division of Investment Management by the summer that responds to public comments and suggestions. Driscoll said he thinks the SEC will take about six months after that to implement the rule, with a final version taking effect Jan. 1, 2009, just prior to the change in administration.

If the SEC's summary prospectus proposal is successful, a similar call for concise disclosure documents could spread to 401(k)s and other retirement plans.



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