

Securities Industry News

May 12, 2008

www.securitiesindustry.com

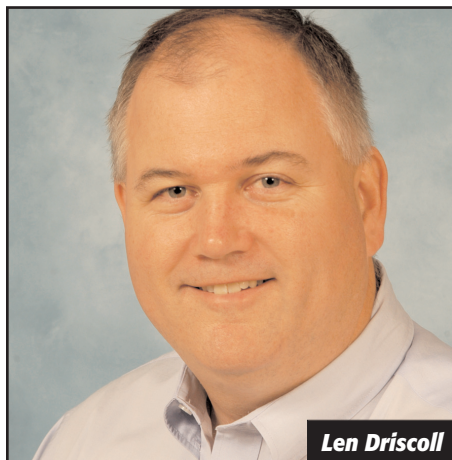
GUEST COMMENT

A Prospectus Investors Can Understand

BY LEN DRISCOLL

In an effort to minimize increasing fulfillment costs, fund companies have been combining multiple fund prospectuses into a one-size-fits-all prospectus document distributed in a single mass mailing. These phone-book-sized documents may contain as many as 30 to 40 funds and be hundreds of pages long. In fact, city apartment dwellers often are unable to receive these documents because they won't fit into their mail slots.

What began as a noble effort to inform investors and protect them has resulted in "investor disclosure" that is costly, wasteful and confusing. As the industry moves toward greater transparency in mutual fund sales transactions and standardization of information, a central need has been simplicity. After more than a decade of effort by the fund industry and the U.S. Securities and Exchange Commission, it appears the answer is on the horizon.



Len Driscoll

On Nov. 21, the SEC announced a proposed rule for a shorter, simpler, standardized prospectus that would tell investors what they need to know within 3 to 4 pages and provide Web access to more detailed information if desired. The stated goal is to provide the average investor with clear, succinct information and also to standardize information to facilitate fund-to-fund comparisons. In the subsequent months, the rule has received over 90 percent favorable commentary and has been endorsed by the Investment Company Institute (ICI), perhaps the industry's most powerful trade association with member firms that manage total assets of more than \$12.33 trillion and serve nearly 90 million investors.

A study by Forrester Consulting—commissioned by NewRiver—also revealed strong industry support for a streamlined short-form prospectus. Forrester conducted an online survey of 150 companies that sell mutual funds and annuities and determined 95 percent would consider using the summary prospectus in lieu of the current statutory, long-form prospectus. According to the study, respondents recognized that the summary prospectus could provide significant savings and better ways to fulfill investor communications. Ninety percent of respondents would consider combining the trade confirm with the summary prospectus into a single mailing to reduce postage costs, and 86 percent would likely explore electronic delivery—the most cost-efficient and “greenest” form of disclosure document delivery available.

A Streamlined Prospectus

The SEC's proposal is designed to simplify investor disclosure by providing fund investors with a more easily readable document for making investment decisions, as well as offering an enhanced capability to make fund-to-fund comparisons. The proposed rule includes two key components:

- **Summary Prospectus.** A streamlined prospectus would be delivered to fund investors for mutual fund sales or

confirmation in lieu of the current statutory prospectus required by the Investment Company Act of 1940. The summary prospectus could be delivered in print or electronically—with electronic consent—and would contain standardized information that must also appear at the front of the current statutory prospectus. Fund companies would also be required to make it available online.

- **Layered Disclosure on the Web.** A layered approach would allow investors to access online more information than is contained in the summary prospectus. Fund companies would be responsible for providing electronic versions of the statutory prospectus, statement of additional information, shareholder reports and supplements. All of this information would need to be organized by individual funds, although separate share classes may be combined under a single fund.

If the rule is passed, over 600 fund companies would be required to file the summary prospectus and include the document at the front of the more than 8,000 U.S. mutual fund prospectuses available, as well as any future funds. Summary plan information must be presented separately for each fund in a multiple-fund prospectus. A single fund offering more than one fund class via a prospectus could integrate summary information for all fund share classes.

If financial intermediaries wish to deliver a summary prospectus to investors, it would behoove the fund companies to make the stand-alone document available. In this case, the fund companies would submit two separate filings on the SEC's mutual fund database, Edgar, or Electronic Data Gathering, Analysis and Retrieval, system—the summary prospectus included at the front of the statutory prospectus and a stand-alone summary prospectus. Fund companies would also be required to provide a URL inside the summary prospectus for investors to electronically access the statutory prospectus and other related fund disclosure information.

Investors and the Environment

Forrester estimates the summary prospectus could save fund companies \$300 million annually. Even greater cost savings could be achieved by combining the summary prospectus and the trade confirm in a single mailing or by moving away from print-based document delivery to cost-efficient e-delivery. In fact, many believe the summary prospectus and its layered disclosure via the Web will be a huge impetus to migrate the industry from paper-based to electronic disclosure. Gone will be the days of “pick and pack” warehouse fulfillment as digital print-on-demand and e-delivery with electronic consent gain a new stronghold.

The industry spends roughly \$1 billion each year producing and delivering paper prospectuses, yet studies show 67 percent of investors don't even read it. When you factor in other forms of disclosure—such as semiannual and annual reports, supplements and statements of additional

information—the total annual bill for paper-based investor disclosure is \$5 billion.

It's not just the length of the fund prospectuses that's an issue—the content is hard to decipher. According to a 2006 ICI survey, 60 percent of investors say prospectuses are hard to understand. Locating information pertaining to a single fund can also be a challenge in a multi-fund prospectus combining sections with 30 to 40 funds. Adopted properly, the summary prospectus would provide investors with a form that is easy to read and understand, and that provides access to more detailed information, or even the statutory prospectus, with two mouse clicks.

The Department of Labor (DoL) worked in conjunction with the SEC as it prepared the summary prospectus proposal. Why is this important? The DoL is responsible for the 55 million Americans who participate in 401k plans. The regulations around prospectus delivery to plan participants have not been as strict as those relating to retail investors. In fact, unless an individual's retirement plan qualifies under Section 404(c) “safe harbor” provisions, he or she may never see a prospectus. Section 404(c) compliance provides plan fiduciaries wider protection against liability for the results of participant investment decisions.

If the proposal is enacted, the DoL is expected to mandate a similar provision for all 401k plans requiring that all plan participants be provided a summary prospectus and a Web site where they can electronically access the statutory prospectus and other related disclosure information.

The SEC received comments from 124

different individuals and investors during the period from Nov. 21 through Feb. 28. Many proposed rules come under intense criticism from industry organizations and financial services companies during the “open call” of the SEC's comment period. As was foreshadowed by the results of the Forrester study, the proposed summary prospectus rule received an overwhelming amount of favorable reviews for the spirit of the rule. Sixty-six individuals and industry giants including American Funds, Fidelity Investments and Vanguard voiced strong support.

As individuals now bear more of the responsibility for paying for their retirement, the investments they make through brokerage accounts and retirement plans are critical to securing their financial future. For too long the industry has spent too much money and wasted resources to over-communicate to investors. Investors need clear, concise information about their investments and ready access to additional information.

The summary prospectus offers a significant opportunity to reduce costs and investor confusion with a better, simpler model of investor disclosure. And it offers a promising bridge toward greater transparency and clarity in investor communications and mutual fund transactions. It's time to deliver a simplified prospectus that investors will read and understand.

Len Driscoll is VP of product marketing at Andover, Mass.-based NewRiver, an electronic compliance and intelligent document fulfillment company.