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SEC Mulling Rule for Shorter Prospectuses

By John Morgan

After more than a decade of fits and starts for prospectus profiles, it appears that both the mutual fund industry and the **Securities and Exchange Commission** are finally comfortable with the idea.

More than 90% of mutual fund providers said they would consider a switch from mailing full-length paper prospectuses to a shorter, condensed form, supplemented by access to the full prospectus via the Internet, according to a survey of 150 firms on short-form prospectuses by **Forrester Consulting**, commissioned by **NewRiver**.

Mutual fund providers are currently required by law to disclose their objectives, strategies, past performance, top holdings, risks and fees in prospectuses at the point of sale and then both annually and semi-annually thereafter by mailing these bulky, often 100-page reports.

But the law may be about to change. The Securities and Exchange Commission is currently looking at ways to reform the mutual fund disclosure framework.

Andrew J. Donohue, director of the SEC's division of investment management, testified before the **House Ways and Means Committee** on Oct. 30 on how the Commission has worked with a mutual fund task force organized by the **Financial Industry Regulatory Authority** to create a two-page "profile plus" document.

"This should help investors who are overwhelmed by the choices among funds, which are too often described in lengthy and legalistic prospectuses," Donohue said. "A concise mutual fund summary could enable investors to readily access key information that is important to an informed investment decision, including information about fund fees."

Certainly, investors would prefer not to be inundated with information they can't understand. Four out of five investors surveyed said they would prefer receiving a concise, to-the-point version of an investment prospectus with graphics and charts, to a long and detailed description, according to an August 2006 study by the **Investment Company Institute**.

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— Andrew J. Donohue
Director, Division of Investment Management
Securities and Exchange Commission

"Two thirds of investors do not read prospectuses. They just throw it in the trash," said **Len Driscoll**, vice president of product marketing at NewRiver.

"The current prospectus delivery method provides information in an arcane format that's hard for investors to digest," according to the Forrester report.

The SEC first proposed a "prospectus profile" in 1995 and gave it a trial year in which fund providers were allowed to send investors a shorter form of the prospectus, but did not remove the requirement to also provide the long version.

But most fund companies were reluctant to take on the additional cost and burden of sending two versions of the same report, and many have legal liability concerns that a shorter version could be accused of omitting facts.

The new rule would require providers to continue filing a large prospectus form with the SEC and make it available on their websites, and send a short-form version to investors, unless an investor specifically requests the long version.

It would be preferable for an investor to get a two-page document right at the point of sale confirming their purchase, summarizing their investment and listing any conflicts of interest, Driscoll said. Investors could access more detailed information on the Internet or request for it to be mailed in hard-copy form, he added.

"The SEC is realizing that the vast majority of people are comfortable with using computers and the Internet," Driscoll said, noting that "most mutual fund investors use the Internet to do financial activities."

According to the ICI, a majority of fund investors use the Internet and say it saves them time and provides them with up-to-date investment information. In 2005, 88% of mutual fund shareholders had access to the web, compared to 79% of all Americans. This is up from 2000, when 68% of mutual fund shareholders had access to the web, versus 57% of all Americans.

Investors age 35 and younger are more likely to use the Internet to view financial information, while investors age 60 and older are more likely to prefer receiving financial information through the mail or from a professional financial adviser, ICI found.

"Regardless of their age or current use of the Internet, the majority of all recent fund investors believe obtaining investment information online is the wave of the future," the study said.

Driscoll said the new rule will help foster the industry's migration away from warehouse "pick and pack" fulfillment and toward digital print on demand.

Forrester estimates that widespread adoption of the short-form prospectus could save the mutual fund industry approximately $300 million a year on the $1 billion it currently spends on printing and postage costs.

"Not only does the investment industry spend exorbitant amounts of money printing and sending these often unread prospectuses, the environmental impact of producing and shipping all that wasted paper is irresponsible in today's climate of sustainability and energy efficiency," Forrester said.

Eliminating the production of billions of pages of unread financial material is an environmentally sound business practice, Driscoll said.

Driscoll anticipates the SEC's rule on short-form prospectuses to come out in the next 30 days, followed by a comment period. If approved, the final rule will take effect sometime in calendar year 2008, he said.

As seen in **Money Management Executive**, *Nov. 12, 2007*