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Shorter Prospectus Raises Industry Hopes, Fears

by Peter Ortiz

Financial firms that sell mutual funds appear eager to replace the lengthy legal documents they send to investors with the short-form prospectus now under consideration at the SEC. Yet, those same firms are leery of the legal and liability issues that remain if that longer document is abandoned.

Indeed, according to a recent Forrester Consulting survey of the financial services industry, 64% of respondents said they were very likely to consider delivering a short-form prospectus to investors instead of the current documents. Another 31% said they were somewhat likely to do so.

Yet, 66% of respondents cited legal concerns as a barrier to adopting the short form, much in line with concerns expressed throughout the fund industry (see Ignites April 5, 2007, story "SEC Lacks Clout to Reform Prospectus: Attorneys"). Other concerns cited in the survey include investor/shareholder preference for the current long-form prospectus (41%) and organizational changes needed to make the switch (25%).

Forrester polled 150 companies that sell retirement funds, mutual funds and annuities, including fund shops, brokerages, banks and insurance companies.

"I don't think the chorus out there in the great financial advisor world has really shifted dramatically," says Jeff Keil, principal at Keil Fiduciary Strategies. "They are really saying the same thing they said before: 'We don't want to take on the liability if somebody buys a fund with just looking at the profile. You need to find a better model for us so we feel we are protected.'"

The difficulty is that fund prospectuses have become legal documents that serve to protect fund firms from liability because they are chock-full of disclosures. That's anathema to providing investors simple disclosures about the funds in which they invest.

And when the fund industry is fearful of the looming plaintiff's bar, it is hesitant to abandon a document that provides such protection.

But Carl Frischling, partner at Kramer Levin Naftalis, is hopeful that the SEC is addressing concerns about the short-form prospectus. He says the final proof will come when the SEC releases details. But Frischling cites Andrew "Buddy" Donohue, director of the SEC's Division of Investment Management, as addressing concerns about the ability of a two-page form to cover the information a fund is legally obligated to present. Frischling expects the SEC to release details on its proposal by this year.

"No way [the SEC] would come out with something... that would be leaving somebody out there on a limb," Frischling says. "That is not the SEC's objective."

Both Keil and Frischling agree on the objective of the short-form prospectus, which is to give investors simple, concise and useful information.

The Forrester survey also points to a \$300 million annual savings in printing and postage costs if the short-form prospectus were adopted, reducing the average 40-page document to two pages. Len Driscoll, VP of product marketing for New River, which commissioned the Forrester study, also notes the positive response survey participants had when asked about combining point-of-sale disclosures with the short-form prospectus.

The survey asked, "If point-of-sale disclosure is passed, to what extent would you consider a solution where the advanced disclosure is combined with the short-form prospectus and printable or e-delivered by the broker to be desirable?" Thirty percent responded "very desirable" and 42% "somewhat desirable." New River is a technology service provider that helps financial firms move from paper to electronic disclosure.

"The industry had some concern that it was too expensive," Driscoll says. "[But] as the technology has improved there may be a way to tie the short-form prospectus in with the point-of-sale disclosure and have a nice, clear concise document."

Driscoll also pointed to an earlier statement by SEC chairman Christopher Cox when he was interviewed by Ignites in its fall 2007 Tech & Ops Special Edition. When asked if he could assuage the fears of firms that were concerned there might be some potential legal risk in having a two-page prospectus, Cox replied: "The legal liability that's already attached to the provision of information in printed registration statements will be identical to the legal liability that will attach when that same information is delivered in an electronic form."

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