

# KIRKLAND & ELLIS

Kirkland Alert

## SEC Adopts Amendments to Streamline Shareholder Reports and Update Advertising Rules for Investment Companies

21 November 2022

The Securities and Exchange Commission (the "SEC") recently voted to adopt rule and form amendments<sup>1</sup> requiring mutual funds and exchange-traded funds registered on Form N-1A ("open-end funds" or "funds") to transmit more streamlined shareholder reports to investors. These amendments will fundamentally transform shareholder reports and require open-end funds to present key information in a concise format that may be as short as three pages in length. Significantly, the amendments also exclude open-end funds from reliance on Rule 30e-3 under the Investment Company Act of 1940, as amended (the "1940 Act"), which will require those funds to deliver copies of their shareholder reports,<sup>2</sup> instead of providing those reports exclusively online and notifying shareholders of their availability.

The SEC also voted to adopt amendments<sup>3</sup> to investment company advertising rules requiring that fee and expense presentations in advertisements and sales literature be current and consistent with relevant prospectus fee table presentations. These amendments affect open-end funds as well as registered closed-end funds (together with open-end funds, "registered funds") and business development companies ("BDCs").

The amendments will become effective 60 days after their publication in the Federal Register. The SEC is generally providing an 18-month transition period after the effective date of the amendments, except that registered funds and BDCs will be required to comply with the amendments addressing representations of fees and expenses that could be materially misleading as of the effective date of the amendments.

# Concise Shareholder Reports

In adopting the amendments, the SEC noted that shareholder reports are often more than 100 pages in length, and retail investors are required to sift through extensive financial information, making it difficult to fully comprehend the materials and make informed investment decisions.<sup>4</sup> Under the new framework, shareholders will receive streamlined semi-annual and annual reports that present limited information the SEC believes is useful for retail investors to assess and monitor their investments. Funds will be required to refer in their reports to the availability of certain additional information on their websites and to deliver the information free of charge upon request.

The final rules generally allow a fund to include in its shareholder reports only the information that new Item 27A of Form N-1A specifically permits or requires – including concise discussions of fund expenses, performance and portfolio holdings.<sup>5</sup> The amendments provide flexibility for funds to use graphics and text features in their presentation of materials in shareholder reports. Funds will be required to tag the information in their shareholder reports using Inline XBRL structured data language.

Notably, the amendments require funds to prepare separate shareholder reports for each series of a fund and for each share class of a fund. Shareholders who hold more than one class of a fund will receive separate reports instead of a single report. The SEC's stated goal is to ensure that shareholders receive information more narrowly tailored to their specific investments and to reduce the complexity of the disclosures.<sup>6</sup> A summary of this narrowly-tailored information is provided below:

## Fund Expenses

Shareholder reports will be required to include one expense table showing certain enumerated "costs" associated with a hypothetical \$10,000 investment, both as a percent of a shareholder's investment in the fund (i.e., the expense ratio) and as a dollar amount.<sup>7</sup>

## Performance

Funds will continue to be required to include in their annual reports a narrative discussion of factors that materially affected a fund's performance during the most recent fiscal year. The SEC is encouraging the use of graphics or text features such as bullet lists, tables or charts to show how the fund performed.<sup>8</sup> Funds will continue to

be required to include a line graph and average annual total return table in their annual reports. However, in light of the other rule amendments, these disclosures will only include the specific class covered in that particular report.

### Portfolio Holdings and Other Information

The amendments require funds to disclose, as of the end of a reporting period, their total number of portfolio holdings as well as their portfolio turnover rates (except for money market funds). Funds will no longer include a schedule of investments in an annual report, but will continue to provide one or more tables, charts or graphs depicting a fund's portfolio holdings by category, as of the end of the reporting period. The complete list of a fund's portfolio holdings and other financial statements, financial highlights and associated information will be removed from shareholder reports, and as discussed below, will be available separately as part of the SEC's "layered" approach to shareholder report disclosure.

In addition, funds will need to disclose their net assets and total advisory fees paid during the reporting period. Funds may also include additional statistical information that they believe would help shareholders understand their operations during the reporting period (e.g., tracking error, maturity, duration, average credit quality or yield), although the SEC encouraged funds to use visuals to relay that information and avoid lengthy narrative discussions.

### Material Changes

Funds will be required to describe material changes to their operations in their annual reports. Specifically, a fund is required to describe material changes during the reporting period with respect to its:

- name, investment objectives or goals;
- annual operating expenses, shareholder fees or maximum account fees, including the termination or introduction of fee waiver and/or expense reimbursement arrangements;
- principal investment strategies and principal investment risks; and
- investment adviser (including any sub-adviser).

A fund also may elect to describe (i) other material changes that it believes may be helpful for shareholders to understand its operations or (ii) anticipated material changes in connection with updating its prospectus for the current fiscal year.<sup>9</sup>

## Availability of Additional Information on Form N-CSR and Online

While funds may provide a summary schedule of portfolio investments and performance information in shareholder reports under the amendments, the complete schedule of a fund's portfolio investments and full financial statements, among other items, will be required to be filed on Form N-CSR on a semi-annual basis and made available electronically or in paper form upon request by shareholders. The SEC's intention with this "layered" disclosure approach is that the additional information included in Form N-CSR and available electronically would be less retail-focused and would be targeted towards financial professionals and investors who desire more in-depth information.<sup>10</sup> The electronic versions of the shareholder reports are also intended to be more user-friendly and interactive.<sup>11</sup>

## Amended Definition of a Broad-Based Securities Market Index

The SEC also amended the definition of an appropriate broad-based securities market index, as referenced in annual reports and prospectuses, to require that funds compare their performance to the index that reasonably represents the overall applicable securities market. In adopting the definition, the SEC explained its belief that investors would benefit from additional contextual information regarding the performance of the fund as compared to the overall market.<sup>12</sup> For example, for a fund that invests primarily in the equity securities of a non-U.S. country, an index representing the overall equity market of the non-U.S. country would satisfy the new requirements. On the other hand, the SEC noted that an appropriate benchmark for a fund that invests primarily in the equity securities of a subset of the U.S. market, such as healthcare companies, should show its performance against the overall U.S. equities market, rather than a benchmark consisting of only healthcare companies.<sup>13</sup>

## Amendments to Rule 30e-3 and Rescission of Rule 30e-1(d)

The amendments exclude open-end funds from the scope of Rule 30e-3 under the 1940 Act.<sup>14</sup> The Rule, which was adopted in 2018, permits certain funds to deliver shareholder reports by making them publicly available on a website, free of charge, and mailing investors a paper notice each time a new report is available in lieu of receiving a complete report. The amendment to Rule 30e-3 ensures that shareholders would directly receive the new tailored annual and semi-annual reports for open-end funds, either in paper form or electronically, if the shareholder has so elected. While many expressed concern regarding the proposed amendments to Rule 30e-3, citing the higher costs involved, the SEC argues that this approach more closely tracks the policy rationale of improving investors' access to and use of fund information.<sup>15</sup>

The SEC also adopted amendments that rescind Rule 30e-1(d), which currently permits a fund to transmit a copy of its prospectus or statement of additional information ("SAI") in place of its shareholder report, if either or both of the prospectus or SAI includes all of the information that would otherwise be required to be contained in the shareholder report. In rescinding this provision, the SEC noted that the consolidation of a fund's prospectus, SAI, and shareholder report disclosures into a single document is inconsistent with the layered disclosure framework it is adopting, and that funds rarely appear to rely on the provision.

### Fee and Expense Information in Investment Company and BDC Advertisements

The rule amendments applicable to advertisements and sales literature published by registered funds and BDCs require that fee and expense presentations be current and consistent with relevant prospectus fee table presentations.<sup>16</sup> Specifically, fee or expense figures in registered fund or BDC advertisements must include certain standardized fee and expense figures, and these figures must be reasonably current and adhere to certain prominence requirements. In adopting the amendments, the SEC noted that current trends in fund marketing (e.g., the trend in marketing low cost funds) as well as the significant effect fees and expenses have on investment returns have made it imperative for the SEC to act on fee and expense presentations in advertisements.<sup>17</sup>

The rule amendments also address representations of fees and expenses that could be materially misleading. The amendments to Rule 156 under the Securities Act provide that representations about fees or expenses associated with an investment in a registered fund or BDC could be misleading because of statements or omissions involving a material fact, including where portrayals of the fees and expenses associated with an investment in such registered fund or BDC omit explanations, qualifications, limitations or other statements necessary to make the portrayals not misleading.

### Technical Amendments to Form N-1A

The SEC also amended Form N-1A to permit a fund to disclose static dates such as birth year and year service began to comply with the requirements to disclose the age and length of service of fund officers, directors and portfolio managers. Prior to the amendments, funds would update the age and years of service of these individuals on an annual basis to comply with the Form N-1A requirements.

### Left on the Cutting Room Floor

A number of proposed rules that were of interest to the industry were not included in the final amendments, including:

- a summary prospectus requirement to describe a fund's principal risks in order of importance;
- the creation of an asset-based exposure standard (10%) for determining disclosure of principal risks in a prospectus;
- the replacement of the existing fee table in the summary section of a statutory prospectus with a simplified fee summary and a simplified fee example in the prospectus; and
- the ability of a fund that invests less than 10% of its total assets in other funds, BDCs and certain private funds to disclose its acquired fund fees and expenses ("AFFE") in a footnote to its fee table and, as a result, excluding AFFE as a fee table line item.

In addition, the SEC did not adopt proposed Rule 498B under the Securities Act, which would have provided an alternative approach for a fund to satisfy its (i) annual prospectus updates and (ii) prospectus delivery obligations to its existing investors under Section 5(b)(2) of the Securities Act.

## Transition and Compliance

Shareholder reports transmitted 18 months or more after the effective date of the rule and form amendments must comply with the amendments. Funds will also have to comply with the amendments to Rule 30e-1, Rule 30e-3 and Form N-CSR no later than 18 months after the effective date by, among other things, meeting the website availability requirements for the new Form N-CSR items.

Fund registration statements, including post-effective amendments, filed 18 months or more after the effective date that are required to include an appropriate broad-based securities market index must include an index that is consistent with the new definition of a "broad-based" index.

The SEC also provided for an 18-month transition period after the effective date to comply with the amendments to the advertising rules; provided, however, that the amendments to Rule 156 under the Securities Act, which address representations of fees and expenses that could be materially misleading, apply on the effective date.

## Appendix A

The table below summarizes the content that open-end funds will need to include in their annual reports or file on Form N-CSR as compared to current shareholder report disclosure requirements.

| <b><i>Current Annual Shareholder Report Disclosure</i></b><br><i>(current Form provision)</i> | <b><i>Description of Amendments</i></b>                               | <b><i>New Rule and Form Provisions</i></b> | <b><i>Discussed in Adopting Release Section</i></b> |
|---|---|--|---|
| –   | Add new identifying information to the beginning of the annual report | Item 27A(b) of Form N-1A                   | Section II.A.2.II.A.2.a                             |
| <b>Expense example</b><br>(Form N-1A Item 27(d)(1))   | Retain in annual report in a more concise form                        | Item 27A(c) of Form N-1A                   | Section II.A.2.II.A.2.b                             |
| <b>Management’s discussion of fund performance</b><br>(Form N-1A Item 27(b)(7))               | Retain in annual report in a more concise form                        | Item 27A(d) of Form N-1A                   | Section II.A.2.II.A.2.c                             |
| –   | Add new fund statistics section to the annual report                  | Item 27A(e) of Form N-1A                   | Section II.A.2.II.A.2.d                             |
| <b>Graphical representation of holdings</b> (Form N-1A Item 27(d)(2))                         | Retain in annual report   | Item 27A(f) of Form N-1A                   | Section II.A.2.II.A.2.e                             |
| –   | Add new material fund changes   | Item 27A(g) of Form N-1A                   | Section II.A.2.II.A.2.f                             |

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|   | section to the annual report   |   |  |
| <b>Changes in and disagreements with accountants</b><br>(Form N-1A Item 27(b)(4))           | Retain in annual report in summary form<br>The entirety of the currently required disclosure would move to Form N-CSR and would need to be available online and delivered (in paper or electronic format) upon request | Item 27A(h) of Form N-1A Item 8 of Form N-CSR Rule 30e-1(b)(2) and (b)(3) | Section II.A.2.II.A.2.g<br>Section II.C.2.II.C.1.c |
| —   | Add provision allowing funds to optionally disclose in their annual reports how shareholders may revoke their consent to householding  | Item 27A(j) of Form N-1A  | Section II.A.2.II.A.2.i                            |
| <b>Financial statements, including schedule of investments</b><br>(Form N-1A Item 27(b)(1)) | Move to Form N-CSR<br>Would need to be available online and delivered (in paper or electronic format) upon request   | Item 7(a) of Form N-CSR Rule 30e-1(b)(2) and (b)(3)                       | Section II.C.1.II.C.1.a                            |
| <b>Financial highlights</b> (Form N-1A Item 27(b)(2))                                       | Retain certain data points but generally move to Form N-CSR  | Item 7(b) of Form N-CSR Rule 30e-1(b)(2) and (b)(3)                       | Section II.C.1.C.1.b                               |

Would need to be available online and delivered (in paper or electronic format) upon request/td>

**Results of any shareholder votes during the period** (Rule 30e-1(b))

Move to Form N-CSR  
Would need to be available online and delivered (in paper or electronic format) upon request

Item 9 of Form N-CSR Rule 30e-1(b)(2) and (b)(3)

Section II.C.1.III.C.1.d

**Remuneration paid to directors, officers, and others** (Form N-1A Item 27(b)(3))

Move to Form N-CSR  
Would need to be available online and delivered (in paper or electronic format) upon request

Item 10 of Form N-CSR Rule 30e-1(b)(2) and (b)(3)

Section II.C.1.II.C.1.e

**Statement regarding the basis for the board's approval of investment advisory contract** (Form N-1A Item 27(d)(6)(i))

Move to Form N-CSR  
Would need to be available online and delivered (in paper or electronic format) upon request

Item 11 of Form N-CSR Rule 30e-1(b)(2) and (b)(3)

Section II.C.1.II.C.1.f

**Management information and statement regarding availability of additional**

Remove from shareholder reports, but information would remain available in a fund's SAI, which

Section II.D

|  |   |  |
|--|---|--|
| <p><b>information about fund directors</b> (Form N-1A Item 27(b)(5) and (6))</p>   | <p>is available online or delivered upon request</p>  |  |
| <p><b>Statement regarding liquidity risk management program</b> (Form N-1A Item 27(d)(6) (ii))</p>                       | <p>Remove from shareholder reports</p>  | <p>Section II.D</p>  |
| <p><b>Rule 30e-3 disclosure, if applicable</b> (Form N-1A Item 27(d)(7))</p>   | <p>Remove from shareholder reports</p>  | <p>Section II.E</p>  |
| <p><b>Funds have discretion to provide other information in their shareholder reports</b> (e.g., president's letter)</p> | <p>Disclosures in the annual report are restricted to that which is required or permitted under Item 27A of Form N-1A (other materials may accompany the transmission of the report, so long they meet the prominence requirements for materials that accompany the report)</p> | <p>Instructions 1 and 12 to Item 27A(a) of Form N-1A</p> <p>Section II.A.1.c</p> |

*\*Associate Ellen Liew also provided valuable research and drafting assistance in support of this Alert.*

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1. [Tailored Shareholder Reports for Mutual Funds and Exchange-Traded Funds; Fee Information in Investment Company Advertisements](#), Release No. IC-34731 (Oct. 26, 2022) (the "Adopting Release"). ↩

2. Under the amendments, shareholder reports may be delivered in paper form or electronically, if a shareholder has opted to receive fund communications electronically. ↩

3. The SEC adopted amendments to Rules 156, 433 and 482 under the Securities Act of 1933, as amended (the "Securities Act"), and Rule 34b-1 under the 1940 Act. ↩

4. Chair Gary Gensler, [Statement on Final Rule Amendments regarding Shareholder Reports](#) (Oct. 26, 2022). ↩

5. Appendix A includes a comparison of the new and current report requirements. Shareholder report information must appear in the order set forth in Item 27A; required items may not be addressed by incorporation by reference; and if the report references other information that is available online, the report must include a link or other means of immediately accessing that information. ↩

6. Adopting Release at 215. ↩

7. New Item 27A includes instructions for funds with short reporting periods or extraordinary expenses, among other things. ↩

8. New Item 27A, however, restricts the amount of information permitted under "Management's Discussion of Fund Performance" and instead requires funds to "briefly summarize" the key factors that materially affected the fund's performance during the last fiscal year, including relevant market conditions and the investment strategies and techniques utilized. In addition, new Item 27A does not require, but does permit, semi-annual shareholder reports to contain items covered under "Management's Discussion of Fund Performance" or disclosure of material changes. ↩

9. The shareholder report must include a legend substantially to the following effect: "This is a summary of certain changes [and planned changes] to the Fund since [date]. For more complete information, you may review the Fund's next prospectus, which we expect to be available by [date] at [website address] or upon request at [toll-free telephone number and, as applicable, email address]." ↩

10. Adopting Release at 128. ↩

11. *Id.* at 24. ↩

12. *Id.* at 74. ↩

13. The SEC noted that, in this situation, a fund could separately show its performance against an additional, more narrowly tailored healthcare index. *Id.* at 77. [↔](#)

14. The amendments do not affect the availability of Rule 30e-3 for registered funds that do not file on Form N-1A (e.g., closed-end funds filing on Form N-2 and management companies that offer variable annuity contracts filing on Form N-3). [↔](#)

15. *Id.* at 25. [↔](#)

16. The rule amendments affect all registered fund and BDC advertisements that include fee and expense figures, including post-filing free writing prospectuses used by registered closed-end funds or BDCs that include fee and expense information. [↔](#)

17. *Id.* at 23. [↔](#)

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## Related Services

### Practices

- Investment Funds

## Suggested Reading

- 17 November 2022 Press Release Kirkland Represents Panacea Venture in Raising and Closing its Second USD Healthcare Fund
- 17 November 2022 Sponsored Event Women's Private Capital Summit 2022
- 16 November 2022 Press Release Kirkland Represents Altaris on Combination of Kindeva Drug Delivery and Meridian Medical Technologies and Financing of Combined Company