

# STEPHEN A. KEEN

February 28, 2008

Ms. Nancy M. Morris, Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

Re: File No. S7-28-07: Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies

Dear Ms. Morris:

I am writing to comment in favor of adopting regulations to permit registered open-end management investment companies ("mutual funds") to deliver prospectuses by notifying investors of their availability at a website, e-mail address and/or a toll-free number. The Securities and Exchange Commission (the "Commission") proposed the regulations in Investment Company Act Release No. 28064, 72 Fed. Reg. 677910 (Nov. 30, 2007) (the "Proposing Release"). I am writing both in my capacity as an individual investor in mutual funds, and as a securities attorney with over twenty years of experience, including seventeen years spent counseling mutual fund advisers.<sup>1</sup>

I would like to address the request for comments at the end of Section II.B.1 of the Proposing Release. I have organized my comments to indicate the specific questions that I intend to address to assist the staff in incorporating these comments into their summary for the Commission.

- 1. Should we permit mutual funds to meet their prospectus delivery obligations in the manner provided in the proposed rule? Does this approach adequately protect investors and provide them with material information about the fund? Does the proposed approach adequately protect investors who have no Internet access or limited Internet access or who prefer not to receive information about mutual fund investments over the Internet? Should we make any other changes with respect to prospectus delivery obligations?**

When the Securities Act of 1933 and the Investment Company Act of 1940 were enacted, paper was the only practical medium for transmitting information filed with the Commission. While it was possible to abstract information from Commission filings and reproduce them in another document, the process entailed considerable expense. More importantly, from the perspective of an efficient market, the process delayed transmission of the information. Market participants who could make decisions based on the filings themselves therefore had a competitive advantage over those who required the information in another format.

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<sup>1</sup> The views expressed are my personal views and should not be attributed to my law firm or to any of my current or former clients.

The widespread availability of personal computers and the development of the Internet have changed these circumstances completely. The information filed with the Commission can be abstracted, reformatted, compared and broadcasted over the Internet quickly and cheaply. So long as the information is maintained in a relational database, software exists that permits investors to arrange and present investment information as they see fit. In today's world, those who rely on a paper filings for investment information are at a disadvantage to those with electronic access to information.

I think we have reached the point where a paper prospectus delivered by mail is less protective of investors than an electronic version in several respects. First, it is easier to locate information in an electronic prospectus. Second, it is easier to abstract information from an electronic prospectus and compare it to information in another electronic prospectus. Third, changes to the prospectus can be disseminated more rapidly to the market. Finally, it would be cheaper to keep an electronic prospectus current, because the mutual fund would not need to incur the cost of producing and mailing a printed copy. The combination of these advantages should result in information being more timely and more readily available to investors, even if each individual investor does not receive a printed prospectus in the mail.

**2. Are there other approaches that would provide mutual fund investors with key information in a user-friendly format?**

There are numerous other approaches to providing mutual fund investors with key information. However, no approach is universally "user-friendly." There may not be as many approaches as there are mutual fund investors, but investors do have different degrees of education, experience and sophistication that lead them to use information differently. For example, a novice investor may require a general primer on investment, which he should look for at a book store rather than in a prospectus. On the other hand, an experienced investor may not require anything more than the quantitative information provided in the most recent annual report and the management discussion of fund performance.

Fortunately, the Commission does not need to concern itself with developing the most "user-friendly" approach. The marketplace has plenty of incentive to develop other approaches targeted at different groups of investors. The Commission can verify this by sending a member of its staff to a magazine stand and having them buy every newspaper and magazine that purports to aid investors in selecting mutual funds. The staff member should then go on line to find comparable websites, including sites offered by broker-dealers and fund sponsors, as well as the major ranking services (*e.g.*, Morningstar, Lipper, Crane Data, *etc.*). This exercise should prove conclusively that mutual fund investors do not want for different presentations of information regarding mutual funds, each emphasizing different elements of "key" information.

Providing mutual fund investors with information is clearly a rewarding business. Given these financial incentives, it is unlikely that the Commission will develop a better means of delivering information than the market will develop. I would therefore urge the Commission to concern itself more with the content of required filings, which provide the raw material that the market tailors into more user-friendly formats, than with the format of the filings or the delivery of filings to investors.

**3. Should we permit mutual funds to meet their prospectus delivery obligations by filing with the Commission and/or by posting online without giving or sending a Summary Prospectus?**

I believe that the Commission is asking the impossible from the summary prospectus, at least insofar as it is looking for a three or four page document with all of the “key” information regarding a mutual fund. What information is “key” depends on the investor, the fund and other circumstances. For example, two years ago, no one was suggesting that the amount of sub-prime mortgage-backed security holdings (particularly indirect holdings through investments in other securities) was “key” information for a mutual fund. However, this past summer mutual funds received thousands of phone calls from investors and dealers trying to find out what exposure their funds had to sub-prime mortgages. This illustrates how a summary prospectus will never be a sufficient means of delivering all the information that every investor might consider “key” to their investment decision.

I believe the Commission is on firmer ground in requiring mutual funds to provide a publicly available electronic prospectus that includes a detailed table of contents and a summary, each linked to a complete discussion of the related item. This should make it easier for investors and their advisers to find “key” information when they need it and for funds to add information that suddenly becomes regarded as “key.” To accomplish this, the Commission need only require mutual funds to provide notice of the web address, e-mail address and toll free number at which the statutory prospectus is available. Mutual funds could accomplish this by including the notice prominently in their confirmations and statements. Statements and shareholder reports (assuming that these are still delivered to shareholders) should also provide prominent notice of any supplements or amendments to the statutory prospectus. There should be no reason to require mutual funds to deliver another document to their shareholders.

My recommended approach would also avoid one of the most significant risks of delivering a summary prospectus to each investor—namely that some investors will conclude that the summary prospectus provides all of the information needed to make an investment decision. An investor who is given some information and told that more information is available on a website might easily conclude that he does not need to review the website or other publicly available information regarding the fund. In contrast, an investor who receives notice that information is available at a website and nothing more should realize that all the information provided at the website may be important. This should encourage investors to either visit the website or else obtain information in a more “user-friendly” format from one of the market sources mentioned above.

My approach also would create regulatory parity between mutual funds and most other investments. Investors trade on securities exchanges every day without receiving prospectuses for the securities they buy, even investment company securities traded over the exchange. Mutual funds are the only investments subject to continuous prospectus delivery requirements, solely because the investors deal directly with the investment company rather than with other investors. The Commission generally relies on the market to disseminate publicly available information to investors, rather than requiring it to be delivered after each initial investment. There is no reason to suppose that the market is any less efficient in disseminating information about mutual funds.

My approach would also avoid the risk of liability that the use of a summary prospectus will necessarily engender. Any summary prospectus will be incomplete, and therefore must omit material facts "necessary to make the statements therein not misleading." No matter what rules the Commission adopts, plaintiffs will always contend that the mutual fund misled investors by hiding "key" information in the statutory prospectus rather than including it in the summary prospectus that was actually delivered to the investor. This same argument is commonly made regarding information in the statement of additional information. Indeed, the press rarely refers to the SAI except to describe it as a place where mutual funds "hide" information.<sup>2</sup>

In contrast, if investors are simply provided with notice of where they can obtain information, there is no basis on which to argue that they received "misleading" information. The notice would force the investor to realize that he is charged with knowledge of all the available information, and ignores it at his risk. This may seem "unfriendly" to investors, but a mandatory disclosure system cannot function if investors can ignore publicly available information and still claim to have been misled. No matter how the Commission drafts the regulations, delivery of a summary prospectus will require mutual funds to choose between risking claims that they withheld "key" information from investors and continuing to deliver full statutory prospectuses to every investor. The Commission should not be surprised if many mutual funds still opt for the second alternative.

I suspect that my proposal (to do away with any pretext of delivering the prospectus by mail) will be too radical for the Commission to adopt. If my suspicion is correct, I have two strong recommendations for the Commission. First, the summary prospectus should *encourage* investors to review the statutory prospectus and disclose the legal risk of failing to do so. Specifically, I would recommend changing the incorporation by reference legend to read as follows:

Before you invest, you should review the Fund's prospectus, which contains more information about the Fund and its risks. You can find the Fund's prospectus and other information about the Fund, including the statement of additional information and most recent reports to shareholders, online at [Web address]. You can also get this information at no cost by calling 1-800-000-0000 or by sending an e-mail request to [e-mail address]. Regardless of whether you obtain this information, federal securities laws and regulations will treat you as having read and understood the Fund's prospectus and statement of additional information, both dated \_\_\_\_\_, and most recent report to shareholders, dated \_\_\_\_\_, which are all incorporated by reference into this Summary Prospectus.

Doubtless someone could craft a plainer statement, but I do not understand how the Commission can defend its proposed liability regulations if the summary prospectus does not warn investors of the risk of failing to access all available information.

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<sup>2</sup> After adopting the final regulations, the Commission should add to its agenda the reintegration of the prospectus and statement of additional information into one document. The SAI will become a vestige of the paper delivery process, and will impair the delivery of information over the Internet by continuing to separate certain information into a separately maintained file.

Second, the Commission should include in the summary prospectus only information that is “unique” to the mutual fund, rather than attempting to define *a priori* what aspects of the statutory prospectus are “key.” As noted previously, whether information is “key” to an investor depends on a variety of circumstances, which will differ by investor, market conditions and other factors extrinsic to the summary prospectus. Assuming that the statutory prospectus contains only material information, any representation that its summary contains all the “key” information necessary for an investment decision will be misleading insofar as a summary must omit some information that is material to some investors.

In contrast, information that is *unique* to a mutual fund may be determined without reference to the investor or other extrinsic factors. Unique information would consist primarily of historical performance, expense and other financial information, investment strategy and related risks,<sup>3</sup> and the portfolio manager.<sup>4</sup> I would not include sales charges (apart perhaps from the fee table) in the category of unique information. Mutual funds in a fund family generally offer the same classes of shares with the same sales charges. An investor not already familiar with these charges would probably benefit by reading the statutory prospectus, where he could learn about such features as rights of exchange, breakpoints and rights of accumulation.

A summary prospectus limited to such mutual fund specific information would reduce substantially the amount of redundant disclosure provided to investors. Investors may legitimately complain that they receive multiple prospectuses with large sections containing identical information, and must then sift out the unique information provided in each prospectus. By isolating the less redundant information in the summary, the Commission could enhance an investor’s ability to find key information that he has not already read in another document.

#### CONCLUSION

Although the phrase is over-used, this is a situation where less is more. By pushing less information to investors in paper format, the Commission should increase the amount of information publicly available to investors. The Commission can rely on the market to transform this publicly available information into user-friendly materials. Thus, more investors will probably access more information about mutual funds if they only receive a statutory prospectus when they actually want to read it.

Through its regulation of broker-dealers, investment advisers and mutual fund advertising (via FINRA), the Commission can continue to protect investors from those who

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<sup>3</sup> I realize that investment risks are not unique to any mutual fund, but different investments strategies necessarily entail different combinations of risks in different degrees. Thus, different mutual funds may give the same risks different emphasis in their summary prospectus.

<sup>4</sup> Although the composition of a mutual fund’s portfolio is also unique information, I would advise against including the top ten holdings in the summary prospectus for three reasons. First, for most funds, the list will often be out of date or quickly become so. Second, it invites investors to focus on holdings rather than the investment strategy itself. Apart from index funds, investors should purchase mutual funds based on how the fund is managed, rather than its holdings at the end of the last reporting period. Finally, until the Commission comes to grip with the effects of derivatives in a portfolio, the proposed top ten holdings may become misleading for funds that utilize derivatives. This final problem might be overcome with extensive notes and qualifications regarding the calculation of the top ten holdings, but this would not be consistent with a summary document.

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are most likely to prepare misleading sales materials. Sources of mutual fund information that who are not compensated for selling mutual funds should not have any incentive to prepare misleading materials, so they should not require Commission oversight. However, even independent sources of information would remain subject to Commission action for securities fraud.

Finally, regardless of what form the final regulation takes, the Commission should clearly disclose in any cross-references the risk of not accessing publicly available information. The Commission should also stop characterizing the information in any summary prospectus as "key." Instead, the Commission should encourage summaries that would allow investors to quickly identify what is unique about each mutual fund.

Thank you for considering my comments. If the Commission or its staff have any questions regarding these comments, please feel free to call me at (412) 288-1567.

Cordially,



Stephen A. Keen