

February 28, 2008

VIA EMAIL

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

Re: Comments on Release Nos. 33-8861; IC-28064; File No. S7-28-07

Dear Ms. Morris,

As a securities lawyer and a member of the investing public, I appreciate this opportunity to provide comments on the Commission's new proposal. I thank you and other staff members who have been working on this proposal. I also thank the Commission for considering my input. It is my sincere wish that this proposal would succeed in promoting the best interest of the investors, as well the mutual fund industry and other parties.

My comment follows this cover letter below. I would welcome further discussion with staff on issues raised in my comment. I can be contacted at my email address, should a need arise.

Yours truly,

Bo Li, Esq.

MEMO

Comment on

Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies (Release No.: 33-8861) (“Proposal”)

(*All specific policy recommendations are underlined as appears in the Memo, and listed within Section VI at the end.)

I. Conceptual Discussion:

The existing securities disclosure framework still to a large degree envisions the investor and disclosure recipient as a self-sufficient individual bravely ready to wade through pages of technicalities inevitably associated with modern commercial enterprises to diligently develop a comprehensive understanding of that particular investment. This assumption should be revised to account for:

- i. ***Process:*** The investment information process is a dynamic one and can be much facilitated by adopting various cognitive devices, such as providing an executive summary at the start, and multi-step drill down. At different stages, amount and depth of information needed differ. Internet would play a major role in this process.
- ii. ***Comparability:*** The key activity in the process is comparing different investment choices. Disclosure needs to facilitate comparability, such as promoting common metrics, and disclosing information in standardized order¹. For screening, an overview is sufficient.
- iii. ***Assistance:*** To capture all the business sophistications in short, plain English welcomed by laypersons may not always be viable or necessary. The irreducible technicalities, which may be material, can be directed towards investment experts, who compete to offer the best advice, and the regulatory authority, which may review and act on behalf of the investors in certain circumstances².

The Proposal's adoption of a summary disclosure, the layered approach, and internet use are in line with those trends. This Comment focuses on various aspects of the summary prospectus.

1 See '33 Act Rule 421(a): “The information required in a prospectus need not follow the order of the items or other requirements in the form.”

2 In a layered disclosure regime, the bottom layer, such as the SAI, may be the depository of the technicalities and minutiae speaking more to an audience of third party experts, advisers, and regulators.

II. Summary Prospectus: Benefits

I find that summary prospectus carries at least these benefits:

1. **Gateway:** In a layered regime, as the gateway document, the summary prospectus is the ideal place to give brief layperson introduction to other deeper-layer information as well as their information quality and legal significance, to enable assessment and choice. Thus, I recommend the following segment to be included in the legend of the summary prospectus:

Useful Information: Strict legal requirements govern this Summary Prospectus and other more detailed documents about this Fund, including Statutory Prospectus, Statement of Available Information, Shareholder Reports. Statement of Available Information supplements Statutory Prospectus. Shareholder Reports updates.

2. **Ease of distribution:** While sharing characteristics with the summary section³ in statutory prospectus, as a separate, light document, compared with the book-sized statutory prospectus, the summary prospectus is vastly easier, less costly to distribute or made available far and wide.
3. **Promoting Internet Disclosure:** The ease of distribution facilitates promotion of the internet, the key component of the disclosure regime to come, by advertising the website of the fund, where a wealth of information can be obtained, interactively, allowing easy drill-down, navigation, and other manipulation.
4. **Cost Savings:** The summary prospectus serves to eliminate the statutory prospectus delivery need for (1) non-statutory prospectus user, who would in all cases refuse to use the statutory prospectus, presumably relying on other sources for investment decision; and, (2) the committed internet users.
5. **Basic Disclosure:** The summary prospectus provides a basic, reader-friendly overview of a fund.
6. **Adequate Disclosure:** In certain circumstances, the summary prospectus can be adequate on its own for investors selecting an investment:

For certain document characteristics, including:

- a) that the summary prospectus substantively constitutes adequate disclosure. The compilation of the summary prospectus is based on surveys of investor information need since before 1999 profile prospectus, with contribution from leading industry organizations such as ICI and NASD; or
- b) that despite deficiencies, further review of statutory prospectus would not change the investor's decision, for various reasons such as low variance between these two

³ The Summary Section in the statutory prospectus may need to be distinctively designated as such to alert the investors for its nature as an overview, to make it functionally comparable with the summary prospectus.

documents;

And, for certain investor characteristics:

- c) that the investor would not or cannot make use of the statutory prospectus for being overly legalistic and complex. In surveys, many investors express such a sentiment.
- d) That third party advice such as that from Morningstar or a broker is more effective or useful than the statutory prospectus in assisting investor decision.
- e) That certain litigation eventualities, such a rule governing the fund investment⁴, or a small-risk accident, are actually not material to the investor at time of the decision.

III. Summary Prospectus: Issues

All the benefits of the summary prospectus would contribute net utility gains, if the investor does move further to obtain the statutory prospectus. The cost of a phone request for the statutory prospectus is small, as phone calls are commonplace in the personal investment process.

A. Inadequate summary prospectus

When an investment decision relied only on a defective summary prospectus with otherwise no adequacy features, then an investor protection failure occurs. As more seasoned investors know how to navigate the various disclosures, the primary audience of the summary prospectus would generally be those novice investors, who are particularly vulnerable.

If so, the Commission needs to adopt a conservative view when evaluating the adequacy of the summary prospectus, in order not to compromise investor protection. As we are weak in the ability to accurately predict the adequacy occurrences of the summary prospectus, the safe approach is to insist on the summary prospectus being followed by the statutory prospectus. The disclosure regime always involving investor choice, and as much as the regulator cannot force reading or understanding of the statutory prospectus, request does not need to be forced. The regulator can and needs to explain to investors the gateway nature of the summary prospectus, discourage over-reliance thereupon, emphasize the centrality of the statutory prospectus, and warn about the danger of forgoing the deeper layer information. A loud and clear message at highest volume possible needs to be crafted, somewhat like this:

***Not Statutory Prospectus:** This summary prospectus is only a limited overview of the information in Fund XYZ's statutory prospectus. The statutory prospectus is the primary document legally required in offering this Fund to investors. It includes detailed descriptions of the risks and important terms and considerations concerning investment in this Fund. You are strongly encouraged to read the statutory prospectus before you invest.*

The considerable benefits, a wide coverage of adequacy scenarios, and the possible remedy for inadequacy commend the adoption of the summary prospectus.

⁴ *White v. Melton*, 757 F.Supp. 267 (S.D.N.Y. 1991).

B. *Strengthening the summary prospectus*

The summary prospectus is physically a separate document⁵. To protect those investors who do not have convenient access to, or fail to make good use of, other resources, particularly the statutory prospectus, and who end up placing reliance on the summary prospectus, it may be strengthened in following ways:

- i. An “Additional Information” section following the standard items, with a cap on length, that allow the fund to address any material peculiarity that do not fit in any required item, and otherwise remedy potential material omission. This preserves the comparability of the summary prospectus, and provides a degree of disclosure flexibility at the same time. This disclosure is comparable to what '33 Act Rule 408 requires⁶.
- ii. For liability concerns, a fund needs to assess whether its unique risk or other business characteristics strain the disclosure capacity of the summary prospectus⁷, even with the “additional information” allowance. If so, the summary prospectus may not be a viable disclosure option for such a fund.
- iii. The Commission should review the summary prospectus as a self-contained disclosure for its adequacy, to the extent possible.

IV. Liability and Risk Exposure

A. *Summary Prospectus Becoming Primary Disclosure Document:*

Receipt of the statutory prospectus⁸ remedies any defect in the summary prospectus. Liability issues arise when an investor bought the fund shares without the benefit of the statutory prospectus being added to the summary prospectus, transforming the summary prospectus into the primary disclosure document for purposes of securities law.

The Commission states that Section 19(a) provides protection from '33 Act liabilities to good faith compliance with the Proposal⁹, with which case law is so far in agreement¹⁰. In addition, the “Not Statutory Prospectus” caution reduces the materiality of any misstatements or omissions contained in the summary prospectus, and puts investors on notice of information in the statutory prospectus that they may be charged with knowledge of information therein¹¹.

5 See SEC Profile Prospectus Release, that finds the profile prospectus is a self-contained document. Incorporation by reference does not by itself physically improve and increase disclosure.

6 Rule 408 (a): “In addition to the information expressly required to be included in a registration statement, there shall be added such further material information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made, not misleading.”

7 Thus the summary prospectus must only be an optional disclosure.

8 There may be various technical issues, particularly with internet involved, as exemplified by Rule 159 concern.

9 With various items in the summary prospectus involving largely hard facts and numbers, good faith compliance may be easier than otherwise to establish.

10 *White, supra*, Note 4.

11 *Majeski v. Balcort Entertainment Co.*, 893 F. Supp. 1397 (E.D. Wis. 1994)

B. Section 11 Liability to be Applied:

While substantially identical with the summary section in the statutory prospectus, the summary prospectus requires adequacy assessment on a stand-alone basis. The applicable liability standard applies to a presumably small group of cases that are marked by: (1) falling outside good faith compliance under Section 19(a); and, (2) being without “Not Statutory Prospectus” type notice¹².

The Commission in the Proposal finds the summary prospectus to be within Section 10(b), thus entitled to be exempt from Section 11. This may be offensive to the principle of fairness, according to Prof. Loss¹³, if issuers and underwriters and other authors¹⁴ of the summary prospectus should be able to walk away, while dealers are under the wrath of Section 12(a)(2), who have to use a summary prospectus as he finds it. To visit liability directly on the authors of the summary prospectus tends to promote better authorship. The professionals also arguably owes a duty to the investing public, under Section 11 appropriately at the level of reasonable care, besides that to the fund.

This context does not fit in Section 10(b) in that it is rather clear that Section does not contemplates a summary prospectus to be the primary disclosure document¹⁵, as is the case at hand. The '33 Act is clearly designed to set the most exacting standard for the primary disclosure document, however it evolves in its physiology.

The diligence is to be applied to examine the summary prospectus as a stand-alone document. As discussed in II-B (ii), the summary prospectus must not be employed were the authors to conclude it cannot be presented satisfactorily, avoiding a near strict liability attaching to the fund.

A policy consideration may have some prevalence, partly from the failed profile prospectus, to exchange regulatory reduction in liability exposure for greater use by the industry of such summary type disclosure, where brevity is easily beset by omissions¹⁶. The rebuttal is manifold in: (1) that the offending cases appear to be limited to the very egregious few; (2) that the fund does have ability to avoid non-optimal use; and (3) that the fund stand to reap considerable benefits offered by the summary prospectus.

V. The summary prospectus in Relation to Sales Literature

Being a lightweight document, easily blended with other papers, the summary prospectus need to be distinguished and guarded in the paper flow. The sales literature that are prepared under the much lower standard of deceit or recklessness as contained in Rule 10b(5) should not be

12 E.g., this notice may not be adopted by the Commission; or, the legend is compromised such as by misprint; or, in rare circumstances, notwithstanding notice to investors, the fault of the fund deprives the aggrieved investor of access to the statutory prospectus.

13 Louis Loss, Joel Seligman, and Troy Paredes, *Securities Regulation* (4th ed. 2006), Section 2-B-5-e.

14 Note that Section 19(a) protects all '33 Act defendants.

15 Under '33 Act Section 10(b), the summary prospectus is only “a prospectus for the purposes of [subsection \(b\)\(1\)](#) of section 5”.

16 Stuart M. Strauss & Jon D. Kaplon, *New Disclosure Rules and Options for Mutual Funds: Do They Open the Door to Litigation and Liability?* 273 (PLI Corporate Law & Practice Course Handbook Series No. B0-002C, 1998).

allowed to confuse investors. The following message should be added to the legend:

Promotional Materials: Except the above documents, the Fund may send you additional materials promotional in nature. The law permits more freedom in preparing them. The promotional materials may be less reliable.

The standard stipulated in the Proposal as “greater prominence”¹⁷ for distinguishing the summary prospectus need to be revised at least to “clearly greater prominence”. Alternatively, or supplementally, the Commission may specify certain minimal packaging, such as: (1) the summary prospectus being the first communication to investors, with time space before sales literature; (2) prominently numbering page from “1 of n” to “n of n”.

The legend should start with a must-have self-introduction : “*This Summary Prospectus is the legally required introduction to Fund XYZ.*”

VI. Specific Recommendations to the Commission:

Summary Prospectus:

1. Summary Prospectus is to be adopted.
2. Summary prospectus is an optional disclosure.
3. An “Additional Information” section following the standardized items, with a cap on length,, that allow the fund to address any material peculiarity that do not fit in any required item, and otherwise to remedy potential material omission.
4. The Commission should require pre-use filing and review the summary prospectus as a self-contained disclosure for its adequacy, to the extent possible.
5. The summary prospectus is given clearly greater prominence than accompanying sales literature, and prominently numbered from “1 of n” to “n of n”

Legend:

6. The Legend shall read as is below:

“This Summary Prospectus is the legally required introduction to Fund XYZ.

Not Statutory Prospectus: This Summary Prospectus is only a limited overview of the information in Fund XYZ's Statutory Prospectus. The Statutory Prospectus is the primary document legally required in offering this Fund to investors. It includes detailed descriptions of the risks and important terms and considerations concerning investment in this Fund. You are strongly encouraged to read the Statutory Prospectus before you invest.

Important Information: Strict legal requirements govern this Summary Prospectus and other more detailed documents about this Fund, including Statutory Prospectus, Statement of Available Information, Shareholder Reports. Statement of Available Information supplements Statutory

¹⁷“If any other materials accompany the summary prospectus, the summary prospectus is given greater prominence than those materials and is not bound together with any of those materials; ...”

Prospectus. Shareholder Reports updates.

Obtaining Information: You may obtain all above documents at no cost by following means:

At the website of the fund:

Through email to:

Call 1800-XXX-XXXX:

By writing to:

The website contains hyperlinks between the summary prospectus and relevant details in other documents, and within other documents.

Promotional Materials: Except the above documents, the Fund may send you additional materials promotional in nature. The law permits more freedom in preparing them. The promotional materials may be less reliable.”

Miscellaneous:

7. In a layered disclosure regime, the bottom layer, such as the SAI, may be the depository of the technicalities and minutiae speaking more to an audience of third party experts, advisers, and regulators.
8. The Summary Section in the statutory prospectus may need to be distinctively designated as such to alert the investors for its nature as an overview, to make it functionally comparable with the summary prospectus.