February 28, 2008

Ms. Nancy M. Morris, Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-0609

Re: Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-end Management Investment Companies [Release Nos. 33-8861,IC-28064; File No. S7-28-07] (Nov. 21, 2007)

Dear Ms. Morris:

I commend the Commission and its staff for their thoughtful efforts aimed at improving mutual fund disclosure. The initiative reflects a laudable objective and marks an extension of previous efforts that have incrementally improved the quality of disclosure that fund investors receive. The proposal on the whole will make fund disclosure mandated under the securities laws clearer and more understandable for the average mutual fund investor. Although I generally favor many of the proposed changes contained in the rule proposal, I also believe, as described below, the rule proposal is flawed from a policy perspective principally because it ignores the relationship between layered mandated disclosure and freewriting on firm web sites.

My concerns have little to do with the core issues of clarity and understandability. The proposal's principal defect in my view is its failure to consider how these proposals (or more precisely the resulting disclosure) will operate in practice in conjunction with fund freewriting and sales literature. This issue is most pronounced on fund web sites where freewriting disclosure exists side-by-side with SEC-mandated disclosure (such as the statutory prospectus, shareholders reports, in some cases the statement of additional information, and in the future potentially the summary prospectus). This side-by-side arrangement from my perspective can lead to what I call the problem of "substituted disclosure" – freewriting disclosure in close proximity to mandated disclosure that fund investors unwittingly (due primarily to lack of sophistication and discernment) treat as being essentially fungible and, in some cases, even a preferred substitute because of its appealing presentation. My concern with the substituted disclosure phenomenon stems, as I explain below, from the Commission's unusual reliance on the ability of self-directed investors to navigate fund web sites. In my view, there is much that is likely to fall through the cracks for average investors in such an approach.

A. The Problem of Substituted Disclosure and Some Examples

As indicated above, the problem of substituted disclosure stems from the fact that average investors are very likely to be influenced by freewriting disclosure found in close proximity to SEC-mandated disclosure even if SEC-mandated disclosure is simplified.

To some extent, this follows as a matter of common-sense intuition. Funds would not invest enormous amounts of money building web sites that provide information in alternative formats unless they believed from a marketing perspective such disclosure is likely to elicit a more favorable response from investor-consumers.

Let me provide what I regard as two problematic illustrations of substituted disclosure. The examples are drawn from Janus Funds web site.[1] The web site can probably be fairly described as state of the art with a variety of investor tools and in some cases some very useful supplemental information. Of course, investors can also access the statutory prospectus and annual report for any fund. But the disclosure that the average "surfing" investor is likely to encounter is of the decidedly marketing variety, limited only by fairly general SEC antifraud and FINRA advertising restrictions.

Example 1: The Index Comparison Chart for Janus Contrarian Fund. Tthe web site (as viewed February 28, 2008) allows the individual investor to easily navigate to a multi-tab exposition of various fund highlights, such as "Fund Overview," "Performance," and "Holdings & Details." In the case of Janus's Contrarian Fund, the S&P 500 Index is the default benchmark setting for a vibrantly colored Index Comparison Chart found under the Performance tab. The Contrarian Fund, to put it mildly, beats the socks off the S&P 500 Index in terms of 3 year cumulative performance.

There are of course footnotes to the chart containing generic disclaimers and other information that might be relevant. For example, as of the end of the last calendar year, 17.7% of the Contrarian Fund's assets were in Indian securities. If you explore the tab on "Holdings and Details", you will also find out that 44% of the holdings of the Contrarian Fund are in foreign securities and 48% of its holdings are in companies with market capitalizations of less than $10 billion. I must confess that I was a little skeptical whether this profile was analogous in character to the S&P 500 benchmark index (but I am not an economist). My own guess is that a more appropriate comparison might be the MSCI EAFE Growth Index which would reveal much less of a performance disparity between the fund's realized performance and the alternative benchmark. To the credit of the fund web site, the investor chart tool allows investors to pick among dozens of index comparisons and so perhaps it is reasonable to assume that the average self-navigating investor would surely locate the appropriate index for comparison.

The lesson for me, however, is what if the average investor is a little less discerning in making comparisons. What impression are they left with? Is there anything in the statutory prospectus or the proposed summary prospectus that is likely to disabuse investors of the potent impression created by Index Comparison chart? Is there any real belief that average investors are likely to spend any significant time studying the

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[1] As a matter of full disclosure, I have an account with the fund family and am a shareholder in the Contrarian Fund from which both examples are drawn. In singling out the Janus Funds, I merely took an example that was personally familiar to me. My guess is that Janus Funds are no better or worse than other fund families who have invested substantially in creating investor-friendly web sites. I might add that the web site contains much useful information that in some respects exceeds SEC-mandated disclosure.

prospectus when they can view a user-friendly eye-popping color distillation of "roughly" the same sort of information on the same web site?

Example 2: The Fund Overview for the Janus Contrarian Fund. I have set forth below in italicized print the primary language from the Contrarian Fund's web page under Fund Overview. Once again, the web site provides a link to the prospectus and the annual report. In the future, the web site will presumably contain a link to the summary prospectus, but in any event investors will be initially confronted with something like the following:

> "***Janus Contrarian Fund***
> ***Where the market sees risk, the contrarian sees opportunity***
>
> ***Who should consider this fund?***
>
> *Investors who want a fund that may perform in all types of market environments because it blends together both growth and value opportunities.*
>
> ***Highlights*** ***{link to more}***
>
> *This fund relies on detailed research to seek out-of-favor companies believed to have unrecognized value.*
>
> *Manager David Decker invests where others are not because he is confident that Janus' research process can uncover opportunities others may have missed.*
>
> *An option for investors who want both growth and value opportunities in a single fund"*

There is nothing intrinsically wrong with this kind of sales patter, but the question is what effect does it have on how average investors make decisions when surfing the web. Do investors place greater emphasis on the freewriting "disclosure" above or the SEC-mandated disclosure? The fund's disclosure regarding investment objectives and principal investment strategies and risk found in the prospectus seem adequate and complete, but I fear that few average investors will plow through the prose and that those that do probably will not retain the same vivid impression conveyed by the web site's freewriting materials. I am equally pessimistic that the summary prospectus will offset the powerful message communicated to prospective investors through fund family freewriting materials delivered on the web in conjunction with (and somewhat more prominently than) SEC-mandated disclosure.

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The significance of these examples from my perspective is that the Commission needs to rethink its approach regarding how SEC-mandated disclosure is used in conjunction with other freewriting materials on fund websites. The Commission's release does not directly address the "substituted disclosure" phenomenon, that is, the likelihood that average investors are most influenced by freewriting on the internet by funds and that as a result, investors are less likely to rely meaningfully on SEC-mandated disclosure provided in conjunction with the freewriting. The Commission should have considered the extent to which pervasive freewriting on fund web sites, in conjunction with mandated disclosure, affects investor decisionmaking. A consideration of the realities of fund marketing on the internet might well argue for a reexamination of now well-established Commission interpretations regarding the use of electronic media by funds.[2] I discuss some modest recommendation on this topic in Part C below.

B. The Premises Underlying the Commission's Understanding of How Average Investors Make Investment Decisions

The Commission's push toward simplification and layered disclosure rests on fundamental premises regarding how disclosure policy should aid average investors in choosing among funds. The goal of "better information" in a "more easily understandable format" begs the question of whether investors are indeed likely to use such information more intensively when found on the internet relative to other forms of freewriting information with which the SEC-mandated materials must compete. The proposing release simply equates expanded and improved choices for investors with providing more effective disclosure to investors. This approach is grounded in the belief that disclosure policy should take an increasingly passive role in determining how investors select among various sources of information as long as information is readily accessible to them. As the Commission's release explains, "the proposal is intended to facilitate investors' ability to effectively choose to review the particular information in which they are interested." In other words, the onus of sifting through SEC-mandated disclosure is squarely on investors regardless of how freewriting materials practically frame the information initially for investors on the internet.

There may be some merit to a passive approach when investors are limited to choosing among different categories of SEC-mandated disclosure. I am openly skeptical of such an approach when applied to situations involving competition between freewriting materials and SEC-mandated materials. I fear the Commission's approach implicitly rests on an unrealistic view of how investors actually gather information on the internet. The self-reliant internet navigating fund investor as a model of the average investor is belied by numerous studies of fund behavior. One law professor, summarizing empirical studies of investor performance expectations, characterized fund

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[2] In 1995 and 1996, the COMMISSION issued important interpretive releases that enabled funds to greatly expand their use of freewriting on the internet. See Securities Act Release No. 7233 (Oct. 6, 1995), 60 FR 53458; Securities Act Release No. 7288 (May 9, 1996), 61 FR 26644.

investor sentiment as pure "fantasy."[3] Behavioral economists studying investor behavior suggest that average investors have difficulty effectively evaluating disclosure that they receive.[4]

What is striking about the approach taken in the release is the rather limited way in which empirical analysis figures in its conclusions. I would happily concede that focus groups may corroborate the view that average investors greatly prefer the summary prospectus over other forms of SEC-mandated disclosure. But this kind of comparison provides very little empirical support regarding the likely effectiveness of summary prospectuses in advancing the goals of disclosure. The Commission should at least attempt to analyze whether investors rely more heavily on fund freewriting materials or SEC-mandated disclosure when freewriting materials are placed in close proximity to the SEC-mandated materials on fund web sites. One way to evaluate the difference might be to compare statistics on "clicks" which most fund family web sites gather. Do the number of clicks relating to the most intensively used freewriting materials of funds generally exceed the number of clicks for a prospectus and if so by how much? Are freewriting materials on the internet currently used twice as intensively as the statutory prospectus? Five times more intensively? Ten times? Fifty times? The Commission release does not address this issue which presumably reflects a judgment that such a consideration is irrelevant to the Commission's role in crafting disclosure policy. Thus, the Commission may well have formulated a better mousetrap in terms of mandated disclosure, but that may be of little comfort if the mousetrap is largely irrelevant to the primary means by which funds solicit investor interest on the internet.

C. The Commission's Authority to Regulate Internet Freewriting and Some Recommendations

One reason that the Commission may be reluctant to tackle the issue of freewriting derives from the basic structure of the Securities Act. Generally freewriting materials accompanying a final prospectus cannot give rise to a violation of Section 5(b)(1) of the Securities Act after a fund's registration statement is declared effective. This proposition provides the basis for fund family web sites containing extensive freewriting materials because such web sites routinely provide access to the statutory prospectus. However, this view is not derived directly from the statute itself but rather

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[3] *See* Henry T.C. Hu, *The New Portfolio Society, SEC Mutual Fund Disclosure and the Public Corporation Model*, 60 Bus. Law. 1303, 1319-23, 1326 (2005) (also noting fund investors prone to "substantial cognitive errors" in evaluating fund costs).

[4] *See, e.g.,* Ronald T. Wilcox, *Bargain Hunting or Star Gazing? Investors' Preferences for Stock Mutual Funds*, 76 J. Bus. 645 (2003) (investors on average are likely to place excessive reliance on information that is "cognitively accessible" in making fund selection decisions and underemphasize more complex forms of information).

the Commission's established interpretive position in connection with use of the internet by funds to disseminate . Although this interpretation may be sound when applied to conventional securities offerings, the Commission should review this position as applied to fund offerings. The Commission has significant administrative authority in the case of fund offerings to place conditions on freewriting materials of registered investment companies delivered over the internet, even when accompanied by a statutory prospectus.

I recommend limiting use of freewriting materials on the internet where the content is not in substance based on content derived from the summary prospectus or statutory prospectus **and** where the challenged materials are likely to be viewed by the average investor as substituting for or interchangeable with SEC-mandated disclosure. Thus for example, in the case of a fundamental information relating to a fund overview as described above, I would recommend that the Commission limit the ability of funds to provide descriptions of funds that do not primarily rest on language found in the statutory prospectus or the summary prospectus. By the same token, I think the Commission needs to be especially vigilant regarding the use of benchmark comparisons contained in freewriting materials that are likely to assume greater prominence for investors than performance disclosure contained in the summary prospectus or the statutory prospectus. Indeed, the Commission may need to revisit disclosure requirements relating to benchmark comparisons as currently provided in SEC-mandated disclosure.

D. Other Issues: Investment Performance Attribution, Incorporation by Reference Disclosure, and Designed for Securities Professionals,

I have confined my comments to the relation between freewriting materials on the internet and SEC-mandated disclosure. There are several issues that I will mention only briefly.

First, the Commission should consider explicit disclosure requirements regarding investment performance attribution in fund statutory prospectuses.[5] Such disclosure is frequently provided to the board in evaluating fund performance and may of course figure in the management fee evaluation. Such information in summary form, however, would be invaluable for investors in understanding the overall performance of a particular fund.

Second, I have doubts regarding the extent to which the Commission proposes to permit incorporation by reference in the summary prospectus. Admittedly the profile prospectus was overly restrictive in this regard, which may well have contributed to the limited use it received. Nevertheless, the current proposal goes too far in the other direction. I believe the proposal permits incorporation by reference from too many documents which is likely to prove confusing to average investors. I would instead limit incorporation by reference in the summary prospectus to matters found in the statutory prospectus and prohibit incorporation by reference of information whose materiality exceeds that of information disclosed in the summary prospectus. I am also concerned

[5] *See generally* David Spaulding, *INVESTMENT PERFORMANCE ATTRIBUTION: A Guide to What It Is, How to Calculate It and How to Use It* (McGraw-Hill 2003).

that the solicitation of comment on this issue did not fairly apprise the public of the liability-limiting consequences of the release's relatively broad approach to incorporation by reference.

Third, the Commission has given priority to simplification of SEC-mandated disclosure for average investors. I feel that the agency has heretofore overlooked an important corollary to its current disclosure initiative. If in fact average investors are better served by simplified disclosure found in a summary prospectus and the statutory prospectus, that logic should also argue for disclosure initiatives especially suited for the needs of securities professionals in more detailed and technical disclosure documents, such as the statement of additional information. The Commission should begin to consider how disclosure in the statement of additional information might be crafted to better suit the information needs of securities professionals and other information intermediaries. For example, the risk disclosure found in the statutory prospectus is eminently reasonable for average investors. Securities professionals might well be interested in more rigorous forms of risk disclosure that the Commission decided not to pursue in deference to concerns regarding the ability of average investors to understand such disclosure. Once it is understood that different disclosure documents are being used to meet the disclosure needs of different types of end-users, it may be appropriate to reexamine whether the statement of additional information should be crafted to better meet the sophisticated information needs of investment professionals.

I very much appreciate the opportunity that has been afforded by the Commission to address these important issues of fund disclosure. I also congratulate the Commission on its constructive approach in grappling with these issues.

Sincerely,

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