

# Chapter 4

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## Prospectus Disclosure and Delivery Requirements

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Mutual fund prospectus disclosures are made in the context of registration of the fund and its shares under both the Securities Act of 1933 (the "Securities Act") and the Investment Company Act of 1940 ("Investment Company Act"), which is described in this section.

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**§ 4:1.1 Registration Under the Securities Act and the Investment Company Act**

As mutual funds continuously offer and sell securities (their shares) to the public, they are subject to the same Securities Act requirements as all other issuers of securities. Section 5 of the Securities Act provides that an issuer may not use the mails or other means of interstate commerce to sell its securities unless a registration statement is in effect under the Act with respect to the securities. Section 5 also provides that it is unlawful for an issuer to use the mails or other means of interstate commerce to deliver its securities to purchasers unless the securities are accompanied or preceded by a prospectus that meets the requirements of section 10 of the Securities Act.

Section 7 of the Investment Company Act provides that a mutual fund may not engage in business unless registered under the Investment Company Act.

**§ 4:1.2 The Federal Registration Process**

**[A] Applicable Forms**

Section 8(a) of the Investment Company Act permits a mutual fund to register under the Investment Company Act by notification, and the Commission has specified Form N-8A as the form of Notification of Registration, which for most new funds is only one or two pages long. Section 8(b) of the Investment Company Act requires every investment company which has registered under section 8(a) to file a registration statement with the Commission. Rule 8b-5 under the Investment Company Act requires the fund to file its registration statement within three months after filing the Notification of Registration (or, if the fund's fiscal year ends within this three-month period, within three months after the end of its fiscal year).

The Commission has designated Form N-1A as the form of registration statement for mutual funds that will meet the requirements of both section 5 of the Securities Act and section 8(b) of the Investment Company Act.

**[B] Automatic Effectiveness—Delaying Amendment**

Section 8(a) of the Securities Act provides that a registration statement filed under that Act shall automatically become "effective" twenty days after it is filed with the SEC. However, the SEC staff usually cannot process new filings within that period, and it therefore expects new registrants to include on the cover page of the registration statement automatic "delaying amendment" language pursuant to Rule 473 under the Securities Act. This language in effect gives the

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SEC the power to delay the effectiveness of the registration statement until it is satisfied that the disclosure is adequate:

The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with section 8(a) of the Securities Act of 1933 or until the registration statement shall become effective on such date as the Commission, acting pursuant to section 8(a), may determine.

### **[C] Filing Fees**

No fee is required when filing Form N-8A or Form N-1A. Section 24(f)(1) of the Investment Company Act provides that upon the effective date of a fund's registration statement, the fund will be deemed to have registered an indefinite amount of its securities. Section 24(f)(2) of the Act and Rule 24f-2 establish a system for payment of filing fees within ninety days after the end of each fiscal year of the fund, based on the aggregate sales price of fund shares during the fiscal year, reduced by the value of aggregate redemptions during the year. For this reason among others, new registrants often establish a fiscal year to maximize the period between the effective date of their registration statement and the end of their first fiscal year.

### **[D] Staff Review Process**

When filed, the registration statement is reviewed by an examiner on the staff of the SEC's Division of Investment Management, who provides comments, questions and suggestions to the fund or its counsel. The staff seeks to provide initial comments within forty-five days after the filing, either by phone (to be memorialized by the fund in correspondence accompanying a pre-effective amendment to the filing) or in writing. The timing, nature and extent of the comments can vary widely, depending on factors such as the staff's current workload, the experience of the examiner, the quality of the disclosure in the initial filing, and the extent to which the staff has previously reviewed similar filings by affiliated funds.<sup>1</sup> In general, first-time registrants can expect to receive substantially greater scrutiny, more staff comments

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1. The SEC staff has a "selective review" process for filings containing disclosure that is not substantially different than the disclosure contained in one or more prior filings by funds in the same fund complex. *See* Investment Company Act Release No. 13,768 (Feb. 15, 1984) [hereinafter Investment Company Act Release No. 13,768].

and a lengthier registration process than those with affiliated funds whose previous filings have been reviewed by the staff.<sup>2</sup>

Normally, counsel incorporates the examiner's comments into a "pre-effective" amendment to the registration statement, which also contains the delaying amendment language and is again reviewed by the staff. The fund does not have to accept all staff comments and suggestions, and interaction with the examiner (and in some cases his or her supervisor) is common. However, the fund usually must explain in correspondence accompanying the amendment which comments have not been accepted and why, and sometimes is also requested to provide supplemental information to the staff on various matters of inquiry (which may in turn result in further comments).

The registration process can involve several such amendments, until the staff is satisfied that a final amendment can be filed without the delaying amendment language or the staff agrees to declare the registration statement effective on behalf of the Commission. It is possible to file an amendment without the delaying amendment, even if the examination staff has not been fully satisfied with the fund's previous response to its comments. However, as in all interactions with governmental agencies, there is some value to maintaining a friendly and professional relationship with the staff, even when disagreeing—particularly since the same examiner is likely to be reviewing future filings by the fund and its affiliates.

### **[E] Sales Efforts While Registration Statement Is Pending at SEC**

Rule 430 under the Securities Act permits the distribution of a preliminary prospectus before the effective date of the registration statement, so long as the preliminary prospectus contains substantially all of the information in the final prospectus. Rule 481(b) under the Securities Act specifies the form of a "subject to completion" legend that must appear on the outside front cover page of a preliminary prospectus. Rule 482 under the Securities Act also permits advertisements with certain other information and the "subject to completion" legend.

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2. In its Release adopting the three-part version of Form N-1A, the SEC noted that "[t]he Commission has also generally instructed the staff to avoid as much as possible using disclosure requirements as a means of regulating the conduct of funds, which are subject to extensive substantive regulation under the Investment Company Act." Investment Company Act Release No. 23,064, at n.221 (June 1, 1998). This remains a goal that is not always achieved.

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Oral communications, including oral offers to buy or sell fund securities, are also permissible after filing of the registration statement. However, they are still subject to the antifraud provisions of the federal securities laws.

Caution should be exercised when discussing pending registration statements with news media. The Division of Investment Management reminded registrants in a 1993 “generic comment letter” that

[t]he discussion of a new fund in interviews, in press conferences, or in speeches which are then reprinted, excerpted, quoted, or used in articles or broadcasts before the effective date of the fund’s registration statement may constitute a ‘prospectus’ under Section 2(10) of the 1933 Act that does not meet the requirements of Section 10 of the Act and thereby violates Section 5(b)(1). Such a violation is commonly referred to as ‘gun jumping.’ In such a case, acceleration of the effectiveness of the registration statement may be delayed and a ‘cooling off’ period with a re-circulation of any preliminary prospectus may be required.

In practice, preliminary mutual fund prospectuses are used infrequently. They are distributed most often in connection with the presentations to broker-dealer “gatekeepers” considering distribution of new funds and to prospective institutional investors.

### **[F] Filing Final Prospectus**

The fund is required to file copies of the final versions of Parts A and B of its registration statement with the SEC within five days after the effective date of the registration statement (or within five days after the fund commences a public offering, if later) pursuant to Rule 497(c) under the Securities Act. If the versions do not differ from the forms in the registration statement when declared effective, then the fund can simply file a certificate to that effect pursuant to Rule 497(j). However, if a summary prospectus<sup>3</sup> is delivered alone, it must be filed with the Commission pursuant to Rule 497(k) no later than the date it is first used, even if it is the same form as the material included in Part A. The SEC staff has indicated that each summary prospectus must be filed separately. However, if the fund uses multiple versions of a summary prospectus with different contact information for various intermediaries and distribution channels, it may file only one form with an exhibit showing the varying information.

In addition, an interactive data exhibit must be filed within fifteen days after the effective date. If the form of prospectus filed under Rule 497(c) includes information in response to items 2–4 of

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3. See *infra* section 4:3.2[B].

Form N-1A that varies from the information in Part A of the registration statement as filed, then an interactive data exhibit must also be filed.<sup>4</sup>

### § 4:1.3 General Registration Rules and Regulations

Several general Commission rules and regulations are relevant to the process of fund registration on Form N-1A.

Rules 400 *et seq.* in Regulation C under the Securities Act set forth a variety of provisions relating to the technical and procedural aspects of the registration process, such as dating, filing fees, prospectus type size, consent requirements, calculation of effective dates, procedures for amendments, requests for acceleration of effectiveness, and the like.

Regulation S-X contains the accounting rules for the form and content of financial statements required to be filed under the Securities Act and the Investment Company Act. In addition to rules of general application, Article 6 of the Regulation applies specifically to registered investment companies. Although much of Regulation S-X is primarily of interest to a fund's accountants and the financial personnel of its adviser or accounting service provider, legal practitioners should be familiar with Article 6, which in some cases impacts the types of information that must be included in the fund's registration statement.

Regulation S-T governs the electronic submission of documents filed with the Commission on the "EDGAR" (an acronym for "electronic data gathering and retrieval") system, including eXtensible Business Reporting Language (XBRL)-related documents. It is supplemented by the detailed formatting provisions of the SEC's EDGAR Filing Manual. Although much of this information is of primary concern to financial printers and others engaged in the formatting and electronic submission process, legal practitioners should be generally familiar with the requirements in connection with their review of documentation to be filed with the Commission.

### § 4:1.4 State Registration Requirements

The offer and sale of securities by mutual funds are also subject to state and territorial securities laws (often referred to as "blue sky" laws). These laws generally require the securities to be registered in each state in which they are offered for sale. For a widely distributed fund, this generally means separate registration in most or all of the fifty states, in the District of Columbia, and in one or more territories.

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4. See *infra* section 4:3.9[C].

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This can be a considerable task, as each state has its own laws, exemptions may exist for limited sales or sales only to exempt investors such as financial institutions, not all states use the same registration forms, filing fee schedules vary considerably (ranging from a single fee for an indefinite number of securities to fees with break-points for specified levels of sales), and states require differing annual sales reports and renewal fees at different times. As section 18 of the Securities Act exempts mutual fund shares from substantive regulation by the states (other than antifraud enforcement proceedings), the registration requirements are basically state fee-generating devices.<sup>5</sup> However, careful attention to the process is necessary, as the sale of shares in a state beyond the number of shares registered can lead to the requirement for a rescission offer. Because the state registration process lends itself to an automated and clerical approach, it is usually handled by the fund's administrative staff or its distributor, or by an outside administrator.

## § 4:2 General Disclosure Requirements

Section 8(a) of the Investment Company Act requires the registration statement to recite a fund's policies with respect to eight specified matters (for example, the issuance of senior securities). In addition, Form N-1A contains a specific list of required disclosures. However, in preparing a fund registration statement, other sources of information are available and should be consulted. In addition, a general understanding of the purposes of the registration documents is crucial.

### § 4:2.1 General Disclosure Guidance

Some specific and practical guidance is available in a variety of published Commission releases and guidelines. The Commission's proposing and adopting Releases for the current version of Form N-1A,<sup>6</sup> and for the summary prospectus revisions for registration statements and post-effective amendments contain helpful insights about the Commission's disclosure philosophy and expectations.<sup>7</sup>

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5. The boundary between substantive prospectus regulation and antifraud enforcement is not always clear. *See, e.g.,* *People v. Edward D. Jones & Co.*, 154 Cal. App. 4th 627 (2007), permitting the California Attorney General to sue a broker-dealer for failing to disclose to investors "shelf-space" arrangements with the fund's distributor.
  6. Investment Company Act Release Nos. 22,530 (Feb. 27, 1997), 23,064 (Mar. 13, 1998).
  7. Investment Company Act Release Nos. 28,064 (Nov. 30, 2007), 28,584 (Jan. 13, 2009).



Recently, the Division of Investment Management has released periodic “Guidance Updates” regarding disclosure matters.<sup>8</sup>

Past Commission guidelines may sometimes be helpful. For example, until the Commission adopted the current version of Form N-1A in 1998, the Division of Investment Management published Guidelines for Form N-1A, which provide specific comments about the disclosure requirements of a number of items of the previous version of the form.<sup>9</sup> A number of these Guidelines are now outdated, some explain or restate legal requirements and suggest generic disclosures of the type the Commission no longer favors, and the releases adopting them have now been rescinded. The Commission indicated in 1998 that the Division of Investment Management is working on a revised and updated version of the Guidelines. However, the revisions are not yet available, and on occasion the older guidance can be useful. Also useful are the annual “generic comment letters” published by the Division of Investment Management from 1989 to 1996 to assist registrants with respect to filing and disclosure matters, and the “chief accountant’s letters” published by the Commission’s Chief Accountant since 1994 to assist registrants and their independent accountants with respect to accounting matters.

These letters are supplemented from time to time by letters from the Division to the Investment Company Institute, the trade organization representing most of the participants in the mutual fund industry, regarding specific issues (such as disclosures about “junk” bond investments, disclaimers of liability for telephonic transactions with shareholders, and application of various requirements of Form N-1A). These letters provide specific guidance regarding filing procedures and the Division’s views about the appropriate disclosures for a variety of matters that have come to its attention as a result of its staff’s reviews of many fund registration documents. Presumably all the foregoing will be incorporated into the Division’s revised Guidelines if and when they are published.

Guidance in preparing a fund’s registration documents also can be gleaned indirectly from several other sources. Disclosure documents filed by other funds with similar objectives, strategies, and techniques are useful to ensure that a fund’s documents adequately respond to the requirements of Form N-1A and fully disclose information relevant to particular subjects. They also provide helpful indications of

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8. *See, e.g.*, IM Guidance Update No. 2014-08, Guidance Regarding Mutual Fund Enhanced Disclosure (June 2014) [hereinafter IM Guidance Update No. 2014-08]; IM Guidance Update No. 2016-02, Fund Disclosure Reflecting Risks Related to Current Market Conditions (Mar. 2016) [hereinafter IM Guidance Update No. 2016-02].

9. Investment Company Act Release No. 13,436 (Aug. 12, 1983).

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disclosures currently favored by the Commission staff and fund responses to staff suggestions. Similarly, recent letters or memoranda providing staff comments on other registration statements can be useful and are generally publicly available forty-five days after staff review of the filing is complete. Public pronouncements by members of the Division's staff are reported in various publications. And, as discussed further below, court decisions in connection with shareholder challenges to fund disclosure documents provide helpful hints about specific language to include or avoid.

### **§ 4:2.2 Clear, Concise and Understandable Documents**

The instructions to Form N-1A provide:

The requirements of Form N-1A are intended to promote effective communication between the Fund and prospective investors. . . .

The prospectus disclosure requirements in Form N-1A are intended to elicit information for an average or typical investor who may not be sophisticated in legal or financial matters.

Rule 421 under the Securities Act embodies the Commission's concern that disclosure documents be prepared so that they can be understood by the average investor. This Rule was adopted in 1998, as it had become evident that fund disclosure documents could not be easily understood by many investors because those documents were written by lawyers primarily as documents to avoid potential fund liability under the securities laws, rather than to communicate clearly with the public. The Rule requires information in a fund's registration statement to comply with four general standards.

First, the information must be provided "in a clear, concise and understandable manner." This means:

- (1) . . . Whenever possible, use short, explanatory sentences and bullet lists;
- (2) Use descriptive headings and subheadings.
- (3) Avoid frequent reliance on glossaries or defined terms as the primary means of explaining information. . . .
- (4) Avoid legal and highly technical business terminology.<sup>10</sup>

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10. Rule 421(b)(1)-(4). Notes to Rule 421 further explain what should be avoided:

- (1) Do not use legalistic or overly complex presentations that make the substance of the disclosure difficult to understand.
- (2) Do not use vague "boilerplate" explanations that are imprecise and readily subject to different interpretations.

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Second, information should be understandable without reference to the particular provisions of Form N-1A or Commission rules. In addition, in lieu of repeating information in the notes to financial statements, references may be made to other parts of the prospectus where the information is set forth.

Third, funds must use “plain English” principles in the organization, language and design of the front and back cover pages, and in the summary and risk factors sections, of the prospectus. Although the Rule does not so specify, the instructions to Form N-1A remind drafters that the Rule applies to the entire summary prospectus included in Part A, and as a practical matter the Commission has encouraged the use of these principles throughout fund disclosure documents. In summary, these principles are as follows:

- (1) Use short sentences.
- (2) Use definitive, concrete, everyday words (“if” rather than “in the event”).
- (3) Use the active voice (not “it is believed,” but “the adviser believes”).
- (4) Use tabular presentations or bullet lists for complex material whenever possible.
- (5) Do not use legal jargon (for example, “inter alia”) or highly technical business terms (for example, “beta”).
- (6) Do not use multiple negatives (for example, “not uncommon”).

Finally, the Rule permits funds to use pictures, logos, charts, graphs or other design elements, so long as the design is not misleading and the required information is clear. It encourages tables, schedules, charts and graphic illustrations of the results of operations, balance sheets, and other financial information that present the data in an understandable manner.<sup>11</sup>

These principles are easy to explain and hard to implement. In its 2014 *Guidance Regarding Mutual Fund Enhanced Disclosure*, the Division of Investment Management noted that “[t]here are a significant number of prospectuses, however, in which disclosure remains

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- (3) Do not copy complex information directly from legal documents without any clear and concise explanation of the provisions.
  - (4) Do not repeat disclosure in different sections of the document that increases the size of the document but does not enhance the quality of the information.

11. The Rule notes that any presentation must be consistent with the financial statements and non-financial information, and that graphs and charts must be drawn to scale.

complex, technical and duplicative.”<sup>12</sup> Writing poorly and in legalese is much simpler and takes less time than applying “plain English” principles and thinking. It also complicates the preparation process by requiring lawyers to submit their drafts to the tender mercies of non-legal editors and graphic designers. However, despite the fears of some practitioners that the Commission’s approach to the writing and design of disclosure documents would toss the baby out with the bath water, and result in more litigation about the accuracy of fund disclosure documents, this has not been the case to date.

### § 4:2.3 **Liability Issues**

Fund registration documents have two purposes, and resolving the tension between those purposes is a central function of counsel preparing those documents. First, as discussed in the preceding section, many of the Commission’s past efforts have been aimed at making prospectuses more informative and useful documents for the average investor.

Second, however, fund registration documents are also aimed at effectively protecting the fund and others against significant potential liabilities imposed by the Securities Act for misstatements or omissions.<sup>13</sup> Unfortunately, most fund investors do not carefully read the disclosure documents they receive before investing. When investors lose money, however, these documents are read very carefully by their lawyers.

Rule 408 under the Securities Act succinctly captures this tension:

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.

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12. IM Guidance Update No. 2014-08, *supra* note 8, at 2.

13. For example, section 11 of the Securities Act provides a civil remedy for a registration statement that contains “an untrue statement of a material fact or omits to state a material fact required to be stated therein or necessary to make the statements therein not misleading.” A number of persons may be jointly and severally liable under section 11, including not only the fund, but also its chief executive, financial and accounting officers, its directors, its underwriters, and its accountants. And section 17(a) of the Securities Act is a criminal provision for fraud in the sale of securities. *See also* Janus Capital Grp., Inc. v. First Derivatives Traders, 564 U.S. 175 (2011) (fund’s investment adviser does not have primary liability under Rule 10b-5 for misstatement in fund’s prospectus, as the adviser is not the “maker” of the allegedly false statement).

Rule 405 explains that “material” information means “matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to purchase the security registered.” The concepts embodied in these Rules are central to the registration process. The job of securities lawyers and other compliance personnel preparing a fund’s registration statement is to go beyond the itemized disclosure requirements of Form N-1A by understanding the specific nature and risks of the portfolio operations and service arrangements of a particular mutual fund, and then thinking creatively about the types of information that an investor would generally consider to be important with respect to that fund.

To provide one of many possible examples: A fund indicated in its prospectus that its objectives (a high level of current income and a relatively stable principal value) would be achieved, in large part, by investing in fixed-income mortgage-backed securities with a short average life, rather than securities with longer maturities and greater volatility. The prospectus warned that rising interest rates could cause principal prepayments to occur at a slower than expected rate. However, it did not indicate that the effect of this slow-down would be to convert the fund’s portfolio from more stable short- or intermediate-term securities into more volatile long-term securities. A federal district court, denying the fund’s motion to dismiss a lawsuit by shareholders whose fund shares declined in value when rates rose, held that the prospectus did not adequately disclose the consequences of rising interest rates, and that the omission was material.<sup>14</sup>

The Commission has struggled over the years to reconcile the tension between clear communications and adequate disclosure. In adopting the current form of disclosure documents in 1998, the Commission noted:

When the Commission adopted the [three-part] disclosure format for Form N-1A, the Commission intended that Part A of the registration statement provide investors with a simplified prospectus that, standing alone, would meet the requirements of

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14. *In re* T.C.W./D.W. N. Am. Gov’t Income Tr. Sec. Litig., No. 95 Civ. 0167 (PKL) (S.D.N.Y. 1997). *See also* *In the Matter of Charles Schwab Inv. Mgmt., et al.*, JIC 29552, Securities Act Release No. 9171, Exchange Act Release No. 63,693, Investment Advisers Act Release No. 3136, Investment Company Act Release No. 29,552, Administrative Proceeding File No. 3-14184 (Jan. 11, 2011) (offering documents misleadingly provided that fund was a cash alternative and had only a slightly higher risk than a money market fund); *infra* section 4:4.1[A]. *But see In re* ProShares Tr. Sec. Litig., 728 F.3d 96 (2d Cir. 2013) (reasonably prudent investor should have understood possibly significant losses if shares were held for more than one day).

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section 10(a) of the Securities Act. Part B, the statement of additional information (which is available to investors upon request), includes additional information that the Commission has determined may be useful to some investors and should be available to all investors, but is not necessary in the public interest or for the protection of investors to be in the prospectus.<sup>15</sup>

In modifying the format in 2009, the Commission noted that prospectuses were still widely criticized for being too long, too complicated, and too difficult for comparing investment choices. The Commission therefore adopted a new form of “summary prospectus,” as a portion of Part A, aimed at providing information that is key to an investment decision in a shortened document, with more detail available on the Internet and in an interactive format that facilitates comparison of important data.<sup>16</sup>

The Commission has also noted that both section 19(a) of the Securities Act and section 38(c) of the Investment Company Act protect a fund from liability for actions taken in good faith in conformity with any rule of the Commission.<sup>17</sup> A fund is permitted to incorporate the statement of additional information by reference into the prospectus,<sup>18</sup> and to incorporate both the full prospectus and the statement of additional information into the summary prospectus. In addition, Rule 498 provides that, for purposes of Rule 159 under the Securities Act (and therefore for purposes of the liability provisions of sections 12(a)(2) and 17(a)(2) of the Securities Act), information incorporated by reference in a summary prospectus is deemed to have been conveyed no later than the time the summary prospectus is received.<sup>19</sup> However, the anti-fraud provisions of the federal securities laws do apply to the summary prospectus, and potential liability

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15. Investment Company Act Release No. 23,064, at 100 (Mar. 13, 1998).

16. See *infra* section 4:3.2.

17. In its Release adopting the 2009 summary prospectus revisions to Form N-1A, the Commission stated they believe “that a person that provides investors with a mutual fund Summary Prospectus in good faith compliance with rule 498 will be able to rely on Section 19(a) of the Securities Act against a claim that the Summary Prospectus did not include information that is disclosed in the fund’s statutory prospectus, whether or not the fund incorporates the statutory prospectus by reference into the Summary Prospectus.”

18. See *infra* section 4:3.1.

19. Sections 12(a)(2) and 17(a)(2) of the Securities Act are liability and antifraud provisions having to do with untrue statements or omissions of material fact in the offer and sale of securities. The Commission has taken the position that information conveyed to an investor only after the time of sale (or contract of sale) should not be taken into account for purposes of assessing the application of these provisions.

exists if the information disclosed to an investor (which arguably includes all information in the documents incorporated by reference into the summary prospectus) contains a material misstatement or omits a statement necessary to make the disclosure not materially misleading.

### § 4:3 Form N-1A

Form N-1A is organized in three parts. Part A contains the requirements for the prospectus which will meet the requirements of section 10(a) of the Securities Act and which must be delivered to all purchasers of a fund's shares (referred to as the "statutory prospectus"). Part B contains the requirements for a Statement of Additional Information (SAI), which expands on the information in the prospectus and which a fund must provide to investors upon their request. Part C contains requirements for exhibits and other information (such as the names and addresses of persons who have physical possession of a fund's books and accounts, a fund's undertakings to the SEC, and information about the officers and directors of a fund's investment adviser and distributor), which the fund is not required to provide to investors but is publicly available from the Commission's files.

In 2010, the Commission adopted revisions to Form N-1A that in effect reorganized the form into four parts. A portion of Part A is designated as a "summary prospectus" that, at the option of the fund, can be delivered to all purchasers of a fund's shares in lieu of the full Part A "statutory prospectus," so long as the statutory prospectus is available on the Internet and in paper form upon request.

For those responsible for preparing fund registration documents, there is no substitute for carefully reading Form N-1A from start to finish. In most cases, the Form relatively clearly indicates the substance of the required disclosures. The discussion below focuses only on those portions of the Form where emphasis or supplemental information may be helpful.

#### § 4:3.1 General Instructions

The introductory material in Form N-1A is a set of General Instructions with helpful detail about a variety of nitty-gritty details.

##### [A] Registration Fees

A fund is not required to pay a fee to file the Form with the Commission. Rule 24f-2 under the Investment Company Act establishes a system of annual fees that are paid by registered funds within ninety days after the end of each fiscal year, based on net sales of shares during the year.

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**[B] Organization of Material**

With a few exceptions, a fund may organize its statutory prospectus and SAI in any manner it believes will be easy for investors to understand.

Form N-1A requires seven items to be included in full (without incorporation by reference to other documents) and in the order set forth in the form, in a summary section at the front of Part A, preceded only by a cover page and table of contents, which constitute the “summary prospectus” for the fund if delivered alone to purchasers of fund shares. If Part A covers multiple funds, a separate summary section is required for each fund, except that the required information about the purchase and sale of fund shares, tax matters, and financial intermediary compensation may be combined and presented immediately after the individual fund summaries. Each fund’s summary section may include responses for all share classes of the fund.

**[C] Date of Prospectus**

Rule 423 under the Securities Act requires the prospectus to be dated approximately as of the date that the fund’s registration statement became effective.

**[D] Incorporation by Reference**

A fund may incorporate information in Parts B and C of its registration statement by reference to other documents filed with the Commission, subject to the usual Commission rules.<sup>20</sup> However, except for the summary section of Part A discussed below, a fund currently cannot incorporate information by reference in the prospectus, except in certain specified circumstances (for example, financial highlights information from a shareholder report delivered with the prospectus). In addition, a fund may specifically incorporate the SAI by reference into the prospectus without delivering the SAI with the prospectus. As the SAI contains considerable additional detail about fund policies and risks, prospectuses commonly incorporate the SAI by reference, to attempt to obtain additional protection from disclosure-related liability under the Securities Act. In all instances, Rule 8b-23 under the Investment Company Act requires that a copy of any document incorporated by reference be filed as an exhibit with the registration statement.

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20. For example, Rule 10(d) of Regulation S-K under the Securities Act prohibits incorporation by reference of material that includes incorporation by reference to another document.



The summary portion of Part A for a fund is not permitted to include any information other than the seven items required by Form N-1A with respect to the fund. However, to attempt to obtain additional protection from disclosure-related liability under the Securities Act, the summary prospectus is permitted to incorporate by reference the fund's full statutory prospectus, its SAI, and any information in the fund's shareholder reports that the fund has incorporated into the statutory prospectus without delivering any of them with the summary prospectus, so long as they are available on the Internet and upon investors' request.<sup>21</sup> Documents must be incorporated by direct reference and not by reference to another document in which they are incorporated by reference. The full statutory prospectus may not incorporate by reference a separate disclosure document about share purchase and redemption procedures (which was permitted until 2009).

### **[E] Inclusion of Sales Material**

The General Instructions permit a fund to include sales literature in its prospectus, so long as it does not add substantial length to the document and its placement does not obscure essential disclosure. Thus, funds may include sales literature "wrappers" around the statutory prospectus, labeled as such.

Special rules apply to delivery of sales materials with a summary prospectus. Rule 498 provides that a summary prospectus cannot be bound together with other documents (except for funds available in certain insurance programs), although a number of summary prospectuses may be bound together. In addition, the summary prospectus must be given "greater prominence" than any accompanying materials; the Commission has indicated that this standard is met if the summary prospectus is on top of a group of documents that are provided together, that a simple cover letter is acceptable, but that a wrapper with marketing materials is not permissible.

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21. *See infra* section 4:5.2. The Commission staff has indicated that a summary prospectus may not incorporate by reference the statutory prospectus and SAI "as further amended or supplemented" in the future, rather than specifying the dates of such amendments or supplements. Notwithstanding this advice, some funds have added such language to avoid the expense of supplementing or reprinting the summary prospectus each time the statutory prospectus or SAI is supplemented or amended in a manner that does not directly affect the information in the summary prospectus.

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**§ 4:3.2 Relation of the Prospectus to the SAI****[A] The Statutory Prospectus**

As a general matter, the text of a statutory prospectus is kept as short and simple as possible, consistent with basic disclosure about a fund, not only because Form N-1A is constructed in this manner, but also to minimize prospectus printing and mailing costs if a summary prospectus is not used. Concerns about liability under the securities laws are addressed by including significantly more expansive disclosures in the SAI, which is incorporated by reference into the prospectus. Since few investors in practice request copies of the SAI, printing or duplication costs for the SAI are generally not a concern.

The General Instructions to Form N-1A note that “[t]he purpose of the prospectus is to provide essential information about the Fund in a way that will help investors to make informed decisions about whether to purchase the Fund’s shares described in the prospectus.” The General Instructions make a variety of points about how this is to be accomplished.

The prospectus should assume an unsophisticated readership. The prospectus disclosure requirements “are intended to elicit information for an average or typical investor who may not be sophisticated in legal or financial matters.” It should use “straight-forward, and easy to understand language” and “document design techniques that promote effective communication.” It should “avoid excessive detail, technical or legal terminology and complex language” and “lengthy sentences and paragraphs that may make the prospectus difficult for many investors to understand and detract from its usefulness.”

The statutory prospectus should aim to disclose the essential nature of the fund. It should “clearly disclose the fundamental characteristics and investment risks of the Fund” and “should emphasize the Fund’s overall investment approach and strategy.” It should “help investors to evaluate the risks of an investment and to decide whether to invest in a Fund by providing a balanced disclosure of positive and negative factors” and “should be designed to assist an investor in comparing and contrasting the Fund with other funds.”

In addition, the prospectus should be concise. “The prospectus should avoid lengthy legal and technical discussions; simply restating legal or regulatory requirements to which Funds generally are subject; and disproportionately emphasizing possible investments or activities of the Fund that are not a significant part

of the Fund's investment operations. Brevity is especially important in describing the practices or aspects of the Fund's operations that do not differ materially from those of other investment companies. Avoid excessive detail, technical or legal terminology, and complex language. Also avoid lengthy sentences and paragraphs that may make the prospectus difficult for many investors to understand and detract from its usefulness."

In contrast, "The purpose of the SAI is to provide additional information about the Fund that the Commission has concluded is not necessary or appropriate in the public interest or for the protection of investors to be in the prospectus, but that some investors may find useful. Part B affords the Fund an opportunity to expand discussions of the matters described in the prospectus by including additional information that the Fund believes may be of interest to some investors." The SAI is in effect the home for disclosure of the matters banished from the prospectus, including full explanations of both principal, secondary and other possible investments, strategies and techniques; full description of investment risks, investment limitations and restrictions; and discussion of legal and regulatory requirements to which a fund is subject.

Although "plain English" concepts apply to both Parts A and B of Form N-1A, as a practical matter a greater level of complexity is permitted in the SAI consistent with lengthier descriptions of more sophisticated matters. The General Instructions impose few limitations on the SAI, merely noting that the SAI should not duplicate information in the prospectus unless necessary to make the SAI comprehensible as a document independent of the prospectus. However, a more detailed explanation of matters referred to in the prospectus is not considered to be duplication.

### **[B] The Summary Prospectus**

The summary portion of Part A applies the same general principles within the prospectus itself. The Commission has concluded that even statutory prospectuses prepared in compliance with Form N-1A requirements are too long and complicated and are too difficult for investors to use efficiently in comparing investment choices. The summary prospectus provisions of Form N-1A seek to provide investors with specified information that is key to an investment decision, in a concise, standardized, user-friendly format that is easily accessible (three to four pages at the front of the full statutory prospectus and, if the fund so elects, that can be used as a stand-alone summary prospectus). Whatever loss of information this entails when used alone as a summary prospectus is presumably offset by the requirement for Internet

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availability of Parts A and B, which provides easy access to the full statutory prospectus and easier access than in the past to the full SAI.<sup>22</sup>

Seven prescribed disclosure items must be presented in numerical order at the front of the summary prospectus, and may be preceded only by a cover page or table of contents. If the statutory prospectus covers a number of funds, the summary information for each fund must be presented sequentially in full on a fund-by-fund basis. The only exception is that if information about purchases and sales of fund shares, taxes, and financial intermediary compensation is uniform for all funds, it may be presented immediately following all of the rest of the summary information for all the funds. Information included in the summary section need not be repeated elsewhere in the statutory prospectus. The Commission staff has rigidly limited the information in summary prospectuses to the items and disclosure language prescribed by Form N-1A.<sup>23</sup>

### § 4:3.3 *Investment Objectives*

Item 4 of Form N-1A requires disclosure of a fund's investment objectives or goals. A fund's investment objective is generally described quite simply, in terms such as "the fund seeks to maximize capital appreciation" or "the fund seeks to maximize income consistent with prudent investment risk." In some cases, the investment objective is stated more expansively, by incorporating elements of its investment strategy—for example, "the fund seeks to maximize income consistent with prudent investment risks by investing primarily in investment grade bonds of domestic issuers." However, funds generally avoid this type of statement, as a fund's investment objective usually is designated as a fundamental policy that cannot be altered without shareholder approval,<sup>24</sup> and inclusion of additional language regarding investment strategies decreases the fund's flexibility by elevating the investment strategies to fundamental policy status.

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22. In its 2014 Guidance Regarding Mutual Fund Enhanced Disclosure, the Division of Investment Management complained that summary prospectuses were increasingly too long, and repeated its view that three to four pages is appropriate. IM Guidance Update No. 2014-08, *supra* note 8, at 1 and 2.
  23. For example, in its 2014 Guidance Regarding Mutual Fund Enhanced Disclosure, the Division of Investment Management noted frequent staff comments about the inclusion of impermissible purchase and sale information. IM Guidance Update No. 2014-08, *supra* note 8, at 4.
  24. See section 8(b) of the Investment Company Act. The SEC Release adopting the current version of Form N-1A notes that "[i]n the Commission's view, most investors typically would not expect the investment objectives of their funds to change without their approval," and the Form requires prospectus disclosure if this is not the case. The staff usually requires sixty days advance notice to shareholders of such changes.

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### § 4:3.4 Investment Strategies and Risks

Items 4 and 9 of Form N-1A contain related requirements for disclosure of a fund's principal investment strategies and the associated risks to investors. Item 4 requires summary disclosure of these matters in the summary section of the prospectus. Item 9 contemplates more extensive supplemental disclosure, which may be placed anywhere in the prospectus. As a result, disclosure of a fund's principal investment strategies and risks is in effect a three-tier process, with a summary description in the summary section of the prospectus in response to item 4, a fuller description elsewhere in the prospectus in response to item 9, and supplemental and more detailed information in the SAI.

With respect to investment strategies, Form N-1A contemplates three types of disclosures: identification of the principal types of securities in which the fund will invest; description of any other important policy, practice or technique used by the fund to achieve its investment objectives; and explanation of the adviser's investment approach.

In describing equity securities, the prospectus should indicate the types of securities (*e.g.*, common stock, preferred stock, or convertible securities). It should also indicate the types of issuers, in terms of any concentration (or lack of concentration) in particular regions (*e.g.*, domestic or foreign issuers, companies headquartered or operating principally in Western Europe or Latin America), any concentration (or lack of concentration) in companies in specific industries, sectors or sub-sectors of the economy (*e.g.*, technology or healthcare sectors or sub-sectors), and any focus (or lack of focus) on issuers of a particular size (most often described in terms of "market capitalization" of the issuers—the aggregate market price of the issuers' publicly-traded securities).<sup>25</sup>

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25. The Commission's 1994 "generic comment letter" noted:

While there are no precise definitions for the terms 'small, mid and large capitalization,' there are indices that classify publicly offered companies according to their market capitalization. The staff believes that any fund that uses 'small, mid or large capitalization' in its name must include a definition of the term in its prospectus. . . . Definitions and disclosure inconsistent with common usage, including definitions relying solely on an average capitalization, will be considered inappropriate by the staff. Funds may rely on a 'cap' or 'ceiling' in defining the particular category. In addition, use of a percentage cutoff may be appropriate, *e.g.*, 'small cap' companies defined as those which fall in the lowest 15% of market capitalization of publicly traded companies listed in the United States.

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In describing fixed-income securities, the prospectus should indicate the types of securities (e.g., fixed-income or mortgage-backed debt instruments). It should also indicate any limitations on the maturity of the fund's investments (most often expressed in terms of dollar-weighted average maturity or "duration" of the fund's portfolio) and the ratings of such securities by independent rating organizations (e.g., "investment grade" or "high yield, high risk" securities).<sup>26</sup> Although the Commission has been skeptical about the value of such ratings since the market events of 2007–2010, they continue to be widely referred to in describing fixed income investment strategies.

Examples of other important strategies would be the use of options, futures, and swap arrangements. In 2010, an Associate Director of the SEC's Division of Investment Management sent a letter to the General Counsel of the Investment Company Institute noting that many funds are providing generic descriptions about derivatives that are not adequately specifically tailored to indicate how the fund's investment adviser actually intends to manage the fund's portfolio and the consequent risks.<sup>27</sup>

The instructions to item 9 explain the contemplated disclosure about the adviser's investment approach: "Explain in general terms how the Fund's adviser decides which securities to buy and sell (e.g., for an equity fund, discuss, if applicable, whether the Fund emphasizes value or growth or blends the two approaches)." Any other principal policy, practice or technique used by the fund should also be disclosed. In recent years, examination staff have been increasingly stringent about specifically indicating which strategies are "principal."

The instructions to item 9 contain helpful instructions about identifying a fund's "principal" investment strategies.<sup>28</sup>

"Whether a particular strategy, including a strategy to invest in a particular type of security, is a principal investment strategy depends on the strategy's anticipated importance in achieving the Fund's investment objectives, and how the strategy affects the Fund's potential risks and returns. In determining what is a principal investment strategy, consider, among other things, the

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26. The staff's views about disclosures related to "junk bonds" are set forth in a staff letter to investment company registrants dated October 3, 1989, and a letter to the Investment Company Institute dated February 23, 1990.
  27. Letter from Barry D. Miller, Associate Director of the Division of Investment Management, to Karrie McMillan, General Counsel of the Investment Company Institute (July 30, 2010).
  28. The previous version of Form N-1A defined "significant investment policies or techniques" to exclude practices that placed 5% or less of a fund's assets at risk. That standard was deleted in the current version of the form.

amount of the Fund's assets expected to be committed to the strategy, the amount of the Fund's assets expected to be placed at risk by the strategy, and the likelihood of the Fund's losing some or all of those assets from implementing the strategy."

"A negative strategy (*e.g.*, a strategy not to invest in a particular type of security or not to borrow money) is not a principal investment strategy."

Disclosure is required of any policy to "concentrate in securities of issuers in a particular industry or group of industries (*i.e.*, investing more than 25% of a Fund's net assets in a particular industry or group of industries)."<sup>29</sup>

With respect to investment risks, Form N-1A contemplates disclosure of "the principal risks of investing in the Fund, including the risks to which the Fund's particular portfolio as a whole is expected to be subject and the circumstances reasonably likely to affect adversely the Fund's net asset value, yield, or total return."

The item 4 disclosure in the summary section of the prospectus is limited to a summary of the fund's investment strategies and risks. Thus, for example, the Commission release adopting the current version of Form N-1A indicated that "In the Commission's view, the purpose of the summary risk disclosure in a fund's prospectus is to identify briefly the principal risks of investing in the particular fund and to emphasize those risks reasonably likely to affect the fund's performance. In light of this purpose, the Commission expects a fund, in meeting this requirement, to present only a succinct summary of the principal risks of investing in the fund and not to repeat the fuller discussion of these risks required elsewhere in the prospectus."<sup>30</sup> In addition, item 4 requires specific disclosures for money market funds, funds sold through an insured depository institution such as a bank, and non-diversified funds. It also permits a description of the types of investors for whom the fund is intended, or the types of investment goals that may be consistent with an investment in the fund.

Because the few sentences contemplated in a summary cannot disclose all aspects of the principal investment strategies and risks, funds usually include further detail elsewhere in the prospectus (under a heading such as "Further Information About Investment Strategies

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29. In its pre-1988 guidelines to Form N-1A, the staff noted that in determining industry classification, the staff will ordinarily use the current *Director of Companies Filing Annual Reports with the Securities Exchange Commission*, which is published by the SEC. The staff also noted, however, that a fund may select its own industry classifications if they are reasonable and no so broad that the primary economic characteristics of the companies in a single class are materially different.

30. Investment Company Act Release No. 23,064, at 22–23 (Mar. 13, 1998).

and Risks”). The level of detail to be included in the item 9 disclosure, rather than in the SAI, is a matter of judgment. Thus, for example, the prospectus summary might include a reference to investment in foreign securities involving higher risks than investment in domestic securities, item 9 disclosure might amplify this to explain some of the risks in further detail, and a full explanation of the risks of foreign investments might be included in the SAI. In its June 2014 Guidance Regarding Mutual Fund Enhanced Disclosure, the Division of Investment Management reminded funds that the repetition of the same information in items 4 and 9 indicates that the fund’s item 4 summary is not adequate.<sup>31</sup>

One of the lawyer’s most important tasks in drafting the prospectus is to focus the adviser’s personnel on what the fund is most likely to do. Thus, for example, the Adopting Release notes “the Commission believes that it generally would be inconsistent with the summary risk requirement for a fund to include a ‘laundry list’ of generic risk factors that may apply to any fund and that does not identify the risks of investment in the [particular] fund.” In this process, it is critical to ensure that the portfolio managers who will actually be determining the fund’s investments be consulted and review drafts, for two reasons. First, the focus of items 4 and 9 is the specific fund in question, and not funds (or even similar funds) in general; failure to provide adequate specificity is one of the most frequent comments by Commission staff in reviewing registration statements. And second, more than one drafter has been faced with a dismayed portfolio manager who realizes, after the registration statement has been declared effective and shares are being sold, that he or she cannot implement a strategy as initially envisioned because of inappropriate language in the prospectus and SAI.

#### **§ 4:3.5 Performance Information**

Item 4 of Form N-1A requires the summary section of the prospectus to include a performance bar chart and table immediately following the narrative summary of the fund’s principal strategies and risks. The required information is interpreted relatively rigidly, to assist in comparability among funds.

The performance bar chart shows performance for each of the last ten calendar years (or the life of the fund if shorter), but only for full calendar years. Thus, if a fund begins operation in mid-year, the performance for its initial period of operation will never appear in the bar chart. In addition, the chart only covers periods since the effective date of the fund’s registration statement, and information

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31. See IM Guidance Update No. 2014-08, *supra* note 8, at 3.



will not appear for prior periods in which the fund was operating without public sale of its securities. If the prospectus covers multiple classes of a fund's shares, the fund must choose only one class to include, subject to two requirements: if only one class has ten or more years of annual returns, that class must be chosen; and if all classes have fewer than ten years of annual returns, the class with the longest period of annual returns must be chosen. The information in the bar chart is not adjusted for sales loads, and the text must indicate (if applicable) that returns would be lower if loads were deducted.

The performance table immediately following the bar chart shows the fund's annual returns for one-, five-, and ten-year periods compared with the returns for a broad measure of market performance for the same periods. The performance table may include data for other indexes, which can be other broad-based indexes, narrower sector indexes, customized indexes, or non-securities indexes such as the Consumer Price Index. Like the bar chart, the performance information must be on a calendar year basis, and only for periods after the effective date of the fund's registration statement. However, unlike the bar chart, the information in the performance table is net of sales charges. In addition, the performance table for a fund that has been operating for more than ten calendar years may also include average annual return for the life of the fund. And performance information must be included for all classes of shares.

Prospectuses must also show average annual total returns after taxes on distributions, and average annual total returns after taxes on distributions and redemptions.

The Commission staff has provided guidance for performance reporting in unusual circumstances. The instructions to item 4 indicate that if the adviser has changed during the last ten calendar years, and the successor meets certain requirements of independence from the predecessor, the bar chart and table can cover only the period in which the successor was managing the fund. And in a variety of no-action letters discussed in chapter 17, the staff has permitted the use of performance information for predecessor investment companies or pooled investment vehicles, new classes of existing funds, and new series of master-feeder funds.

#### **§ 4:3.6 Fee Table**

Item 3 of Form N-1A provides for a summary of the shareholder fees (paid out of a shareholder's investment) and per-share expenses of a fund, both in tabular form and in the form of an example showing the fund's total dollar operating expenses under certain assumptions. Item 3 is also applied relatively rigidly by the Commission staff to increase the comparability of data for various funds. However, unlike

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the performance information required in the summary section of the prospectus, shareholder fee and expense information must be provided for all classes of shares.

Although the shareholder fee portion of the table includes a line for the maximum deferred sales charge payable by a shareholder, if a class of shares is subject to a contingent deferred sales charge only during the first twelve months after purchase, the amount of the CDSC need not be included in the chart. The table has a separate line for redemption fees, which are distinct from deferred sales charges. These are fees a redeeming shareholder must pay to the fund (rather than its distributor), and are imposed both to ensure that the transaction costs of redemptions are not borne by other shareholders and to discourage frequent redemptions by market timers and others. The Commission has generally taken the position that redemption fees in excess of 2% of the amount redeemed are not consistent with the Investment Company Act.

The annual per share fund operating expenses in the fee table must be based on the fund's actual expenses during its most recently completed fiscal year. Newly organized funds which have not yet completed a full fiscal year, or with a first fiscal year of less than six months, may use estimated expenses. In all cases, actual expenses may be adjusted for extraordinary expenses as determined under generally accepted accounting principles, with an explanatory footnote. Actual expenses can also be adjusted (with an explanatory footnote) to delete other non-recurring increases or decreases in expenses during the past fiscal year, or to add expenses the fund expects to incur during the current fiscal year, that would materially affect the information presented. However, the fund may not make such adjustments to account for expected future economies of scale or fee breakpoints resulting from an increase in the fund's assets.

The Commission staff has also specified the requirements of the operating expense presentation with respect to fee waivers and expense reimbursements by fund advisers, which are common in the early years of fund operation and for smaller funds. The instructions to item 3 require the expense information to include only actual total expenses before any waiver or reimbursement by the fund's adviser, with expenses net of waivers and reimbursements shown in a footnote. However, if the adviser has agreed to a fee waiver or expense reimbursement arrangement that continues for at least one year from the effective date of the registration statement or amendment, the fee table may show the amount of the waiver or reimbursement on a separate line as a deduction to the total actual expenses, and a final line may show the net expenses after the waiver. In these cases, a footnote to the fee table must indicate the period for which the arrangement will be in effect and must also describe who

can terminate the arrangement and under what circumstances. Information about a waiver or reimbursement that was not triggered during the past fiscal year may not be included in the fee table or footnotes.

The provisions of the fee and expense table impact the dollar-based Example which must follow the table. The table must show expenses at the end of one-, three-, five-, and ten-year periods. If the fund imposes a redemption fee or deferred sale charge, the amount of the charge must be deducted in the line of the table showing the impact of redemption at the end of the period in question. The table must reflect fees and expenses without waiver arrangements during any period if the arrangements may be terminated for such period without agreement of the fund's board of directors. In addition, if the adviser has agreed to a fee waiver or expense reimbursement arrangement that may be terminated after a fixed period, then all numbers in the table for subsequent periods must assume that the arrangement has not been continued. For this reason, the advisers for some funds have agreed to rolling ten-year terms for such arrangements.

#### **§ 4:3.7 Variations in Sales Loads**

Item 12 of Form N-1A requires that each sales load variation must be applied uniformly to particular classes of investors or transactions, and disclosed in the prospectus with specificity. As the investors purchasing fund shares through each intermediary are considered to be a separate class of investors, disclosures of scheduled variations for a number of separate intermediaries could result in lengthy disclosure that may be difficult for investors to navigate. Accordingly, the SEC staff will not object to including such disclosures for multiple intermediaries in an appendix to the statutory prospectus, or in a separate stand-alone document, with appropriate cross-references and website postings.<sup>32</sup>

#### **§ 4:3.8 Statement of Additional Information**

The information required by the various items of Part B of Form N-1A is generally straightforward. A few matters that are not self-evident bear some explanation.

Item 17 requires a description of certain fund policies and identification whether those policies and any others (including the fund's investment objective) are "fundamental" policies, in accordance with section 8(b) of the Investment Company Act. Policies that are classified as "fundamental" cannot be changed without the

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32. See IM Guidance Update No. 2016-06, Mutual Fund Fee Structures (Dec. 2016) [hereinafter IM Guidance Update No. 2016-06].

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approval of a majority of the fund's shareholders, as defined in section 2(a)(42) of the Act. As a result, funds should be careful to identify as fundamental policies only those which truly are significant enough to merit shareholder action, and to word such policies carefully to ensure that the fund's board of directors and investment manager maintain adequate management flexibility. For example, it may be preferable to identify a fund's fundamental investment objective as "capital growth" rather than "capital growth primarily through investment in equity securities of domestic issuers." Samples of policy restrictions in older SAIs may be misleading in this regard, as prior to the adoption of National Securities Markets Improvement Act of 1996 state securities authorities imposed many substantive restrictions on fund operations that are no longer generally followed.<sup>33</sup>

Item 18 requests disclosure about management of the fund, including directors. Because the fund's management and service providers cannot be expected to know all the relevant personal information about fund officers and directors, it is essential to request all officers and directors to complete a questionnaire that can be used as the basis for the response to item 18.

Item 26 specifies the formulas used for calculating SEC-standardized performance. Although not required, disclosure of the formulas is often included on the theory that the formulas may be material to investors.

### § 4:3.9 Part C

The information required in Part C is also relatively straightforward.

#### [A] Opinion and Consent of Counsel

Item 28 requires the fund to file as an exhibit an opinion and consent of counsel regarding the legality of the registered shares and whether they will be legally issued, fully paid and nonassessable when sold. The "consent" does not only refer to inclusion in the opinion of counsel's consent to the filing of its opinion as an exhibit. For the protection of those signing the registration statement, counsel should also be asked to consent to a reference to its opinion in the SAI. The consent and reference will provide additional protection to the signers under section 11 of the Securities Act, who can then rely with respect to the matters covered on the opinion of an "expert." Counsel's opinion can be incorporated by reference in subsequent amendments to the registration statement, without the need for a new exhibit, if the

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33. For example, state authorities required limits on the purchase of securities issued by "unseasoned" companies with less than three years of continuous business operation.

consent is properly worded. However, if the fund later includes new series or classes of shares, counsel will have to file an additional opinion covering those securities.

**[B] Directors, Officers, and Partners of the Fund's Adviser**

Item 31 requires information about the directors, officers, and partners of the fund's investment adviser. Providing this information for large investment advisory organizations, and keeping it current for subsequent filings, can be burdensome. Some registrants have avoided the need for several pages of listings by incorporating by reference information in the adviser's Form ADV as filed with the Commission under the Investment Advisers Act of 1940.

**[C] XBRL Interactive Data Exhibit**

Commission rules require all open-end funds to file the information contained in the risk/return summary section of their prospectuses (items 2, 3, and 4 of Form N-1A), and post it on their websites, in interactive data format, using eXtensible Business Reporting Language (XBRL). The information must be filed as an exhibit (called an "interactive data exhibit") to the fund's registration statement, or as an exhibit to a prospectus submitted under Rule 497(c) or (e) with risk/return summary information that varies from the information in the fund's registration statement. The interactive data exhibit can be submitted for immediate effectiveness under Rule 485(b), and must be filed after the related filing becomes effective (or the submission under Rule 497), but not later than fifteen days after the effective date. A fund must also post its interactive data file on its website (if it has one) on the same date it is submitted to the Commission.

Until 2011, the SEC permitted voluntary submission of such information,<sup>34</sup> and this program will continue after January 1, 2011 for voluntary filing of financial statement information.

**[D] Exhibit Index**

Rule 483(a) requires an exhibit index immediately preceding the filed exhibits.

**[E] Required Signatures**

Section 6(a) of the Securities Act requires the registration statement to be signed by the fund, its principal executive officer and principal financial and accounting officers, and a majority of its board of

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34. Securities Act Release No. 8823 (July 11, 2007).

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directors. In addition, registration statements for a fund managing substantial assets through a wholly owned subsidiary must be signed by the director of the subsidiary, and feeder fund registration statements must be signed by the officers and directors of the master fund. To avoid the burden of circulating signature pages, the directors and officers frequently execute limited powers of attorney in favor of one or more of the officers who are involved in the day-to-day administration of the fund, permitting those officers to sign the registration statement on their behalf. Several matters should be kept in mind when using this procedure.

First, Rule 483(b) under the 1933 Act requires that the powers of attorney be filed as exhibits to the fund's registration statement.

Second, Rule 483(b) under the 1933 Act also provides that if the required signature of the principal executive officer is provided by power of attorney, this procedure must be approved by the fund's board of directors, and a copy of its authorizing resolution must be filed as an exhibit to the registration statement.

In addition, all fund directors are liable for the accuracy of the registration statement under section 12 of the Securities Act, whether or not they have signed the registration statement or they have signed through a power of attorney. It is therefore important to ensure that all directors receive copies of all filings made under their names in a manner that facilitates their review (for example, by marking the changes made in the document since the last filing). It is frequently not possible to provide directors or a committee of directors with pre-filing copies of the registration statement or amendments for their review and comments. However, it is useful to make a record of the directors' diligence by providing time on the board's meeting agenda for a post-filing discussion and questions about the document. It is also useful to include as a periodic item on the board's meeting agenda a discussion of the process that is used for the preparation and updating of the registration statement.

#### **§ 4:4 Prospectus Updates**

A fund must annually update its statutory prospectus and SAI by amending its registration statement. It may also have to make prospectus and SAI updates at other times during the year, either by formal amendment to the fund's registration statement or by "supplement" to the prospectus or SAI.

**§ 4:4.1 Annual Amendment of the Registration Statement**

The need for an annual amendment to a fund's registration statement arises from section 10(a)(3) of the Securities Act, which provides that when a prospectus is used more than nine months after the effective date of the registration statement of which it is a part, the information in the prospectus must be as of a date not more than sixteen months prior to the date of use. For this purpose, the SAI is also considered to be a "prospectus."

**[A] Information to Be Updated**

Once a fund is in regular operation, every prospectus includes audited financial highlight information for its latest full fiscal year, and every SAI includes or incorporates by reference audited financial statements for that year. Thus, as a practical matter, the financial information in its prospectus must be updated annually, within four months after the end of its fiscal year.<sup>35</sup> Because this is highly material information and involves the filing of accountants' consents, the updated financial statements must be added by post-effective amendment to the fund's registration statement rather than by the prospectus supplement method described below.

To avoid liability under the Securities Act for material misstatements and omissions in an annual amendment to a fund's registration statement, all of the other information in the registration statement must also be reviewed and updated as necessary. Much of this process is routine, to include information previously provided by special supplement, to add new and amended agreements as exhibits, and to update a variety of information such as information about fees and expenses; new or revised portfolio management techniques and instruments; changes relating to officers, directors and portfolio managers; and revised sales and distribution arrangements. For this purpose, counsel should attempt to ensure that the current prospectus and SAI are distributed for review to the appropriate officers of the fund's investment adviser and administrators. An annual update to the fund's officer and director questionnaire should also be circulated for completion.

One aspect of this annual review process requires some careful analysis. As indicated above, prospectus disclosure about investment strategies and risks should focus on what the fund is in fact doing, and

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35. Although prospectuses also normally include other dated information that may become "stale" earlier than the financial statements, the financial statements are generally accepted as the relevant item.

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not what it might do. During the course of a year, the types of securities in which the fund is actually investing and which it intends to emphasize can vary considerably, and the disclosures in last year's prospectus may not be adequate. For example, the portfolio managers of a growth equity fund that previously had substantial aggregate positions in technology stocks, and included an explanation of the attendant risks, may have restructured the portfolio because they view the healthcare industry as providing better prospects. To determine whether prospectus disclosure should change, it is useful to review the portfolio listings in the fund's current annual report (or, if it is not yet available, the latest semi-annual report) and the information provided to the fund's board in connection with its latest renewal of the fund's advisory agreement, and it is imperative to discuss the matter with the relevant portfolio managers.<sup>36</sup> This type of discussion may also identify proposed changes in future portfolio investment policies that may create issues under the Investment Company Act.<sup>37</sup>

The annual review process is also an opportunity to address changes to Form N-1A and evolving disclosure expectations by federal regulators. For example, in October 2016, the SEC revised Form N-1A, effective in July and August 2017, to require additional information regarding securities lending and methods for redeeming fund shares. In 2014–2015, the SEC staff expressed concerns on several occasions about adequate disclosures regarding liquidity, increased volatility, changing market conditions, and other risks by fixed income funds with significant exposure to interest rate increases. During the same period, SEC and FINRA staff expressed frequent concern about the

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36. For another example, see Piper Capital Mgmt., Inc., Initial Dec. Release No. ID-175, 73 S.E.C. Docket 2524-77, 2000 WL 1759455 (Nov. 30, 2000). In this proceeding, a fund with the objectives of achieving a high level of current income and preserving capital initially invested only in U.S. Treasury notes and ordinary government agency securities. The fund later began shifting the overall composition of its portfolio to leveraged investments in interest-rate-sensitive collateralized mortgage obligations. The administrative law judge held that the alteration in the fund's portfolio materially deviated from the objective of preserving capital and was not adequately disclosed in the prospectus. *See also* Northstar Fin. Advisors Inc. v. Schwab Inv. et al., No. 11-17187 (9th Cir. Mar. 9, 2015) (reinstating causes of action claiming that a fund's mortgage-backed securities weightings caused it to deviate from shareholder-approved fundamental investment policies).

37. *See, e.g., In re Charles Schwab Corp. Sec. Litig.*, No. C08-01510 [WHA] (S.D. Cal. 2009), holding that section 13(a) of the Investment Company Act required a shareholder vote before a fund could lawfully deviate from the statement in its SAI that it would treat mortgage-backed securities issued by private lenders and not federally guaranteed as an industry for purposes of its concentration policy.



accuracy, adequacy, and comprehensibility of disclosures regarding alternative investments.

When filing an amendment to the fund's registration statement, Part C must also be updated. However, previously filed exhibits can be incorporated by reference in the exhibit listing.

**[B] Rule 485**

A normal annual amendment to a fund's registration statement, which merely updates the financial statements and makes a variety of other non-material changes, will become effective immediately upon filing pursuant to Rule 485(b) under the Securities Act if the appropriate box is checked on the cover page of Form N-1A.<sup>38</sup> To take advantage of this procedure, the fund must certify on the signature page that the amendment meets all of the requirements of Rule 485(b). In addition, if counsel to the fund has prepared or reviewed the amendment, counsel must furnish to the Commission at the time the amendment is filed a written representation that the amendment does not contain disclosures that would render it ineligible to become effective under Rule 485(b). A fund that fails to submit or post a required interactive data exhibit will lose its right to use Rule 485(b) until the submission or posting is completed.

Immediate effectiveness under Rule 485(b) is also available if one fund in a fund complex has filed an amendment to its effective registration statement under Rule 485(a) to incorporate material changes; the Rule 485(a) filing has become effective; and, at the time of the Rule 485(a) filing, the fund indicated that substantially similar amendments would be filed by other funds in the complex and asked that the subsequent filings be treated as "template filings" permissible under Rule 485(b)(i)(vii). The subsequent filings under Rule 485(b) must indicate that they are relying on this template relief.<sup>39</sup>

If immediate effectiveness under Rule 485(b) is not available, a fund has two other options. Rule 485(a)(2) provides for automatic effectiveness seventy-five days after filing, if the purpose of the filing is to add information about a new series of the fund; the fund may designate a later effective date that may be up to ninety-five days after filing. Otherwise, Rule 485(a)(1) provides for automatic effectiveness sixty days after filing (or on a later date designated by the fund which may be

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38. Rule 485(b) also permits the fund to designate an effective date that is within thirty days after the filing date. This procedure is often used to provide adequate time to print revised prospectuses in advance and get them into the hands of a distributor's network of offices for use on and after the effective date.

39. See Investment Company Act Release No. 13,768, *supra* note 1; IM Guidance Update No. 2016-06, *supra* note 32.

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up to eighty days after filing).<sup>40</sup> If an earlier effective date is necessary, the fund can request selective review of the filing<sup>41</sup> or explain the reasons, and the SEC staff will cooperate in appropriate circumstances to accelerate the effective date of the registration statement pursuant to section 8(a) of the Securities Act and Rule 461 under the act (which requires a written acceleration request by the fund and its underwriter). In all cases, automatic effectiveness is subject to the Commission staff's ability to request the fund to voluntarily file a delaying amendment if disclosure matters remain to be worked out, or ultimately the Commission's ability to issue a stop order under section 8(b) of the Securities Act preventing effectiveness of the amendment.

Whether an amendment is eligible for filing under Rule 485(b), or must be filed under Rule 485(a), can be a difficult matter of professional judgment—and often must be determined in the context of fund management's distinct preference for Rule 485(b). The only guidance is the requirement in Rule 485(b) that the changes must be “nonmaterial.” The Commission has required an amendment including the first filing of a summary prospectus to be made under Rule 485(a).<sup>42</sup> On the other hand, it often permits the filing of a first amendment, incorporating staff comments on a Rule 485(a) filing, to be filed under Rule 485(b), and has allowed funds that have received exemption orders permitting the substitution of sub-advisers without shareholder votes to add information about the new sub-adviser in a Rule 485(b) filing. Presumably, the latter is permitted because such funds are required to provide an information statement to their shareholders (containing most of the information that would be in a proxy statement) with respect to any new sub-adviser and will also have submitted a prospectus supplement to the Commission pursuant to Rule 497.

The extreme cases are easy. For example, revisions to information about directors' compensation are not material, and revisions to the identity of the fund's investment adviser or fundamental investment objective are material. The hard cases are in the gray area in between,

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40. The Commission staff noted in its 1994 “generic comment letter”: “It is the staff's position that the first day after filing is the day following the day of filing, not the day of filing. Thus, for a post-effective amendment filed on November 1, sixty days after filing is December 31 (not December 30). . . .”

41. Investment Company Act Release No. 13,768, *supra* note 1.

42. In a recent administrative proceeding, the Commission stated that information about a change in a fund's industry concentration policy, developed in a Rule 485(b) filing, was material and should have been reflected in a Rule 485(a) filing. *See* In the Matter of Charles Schwab Investment Management et al., Investment Company Act Release No. 29,522 (Jan. 11, 2011).

and the Commission staff generally depends on counsel to make the call and provide the required representation.

A summary prospectus may also have to be amended from time to time in other respects to ensure that the summary information is accurate in all material respects. As such changes would also involve amendments to the summary section of the fund's full statutory prospectus, the prospectus changes would be filed in the same manner as other amendments to the fund's Form N-1A registration statement; thereafter, the revised summary prospectus would be filed pursuant to Rule 497(k) within five days after its first use.

### § 4:4.2 Interim Updates

Events often occur between the normal annual updates of a fund's registration statement that call for correction of or addition to the disclosures in its currently effective prospectus or SAI. Most often they are matters about which fund management has had some advance notice, such as revisions in fund operating policies, changes in service providers, additions of new share classes, or changes in other sales arrangements. Sometimes they are unanticipated events, such as departures of key portfolio managers, significant events affecting the fund's strategies or investments (such as the 2014 Ukraine Crisis or defaults on bonds issued by the Commonwealth of Puerto Rico), or developments with respect to the fund's adviser. For example, staff of the Division of Investment Management has stressed the need for advisers to monitor market conditions on an ongoing basis, assess whether any changes would be material to investors in the funds they manage, and revise fund disclosures if necessary.<sup>43</sup> Occasionally, they must be made to incorporate the effectiveness of changes to Form N-1A.

For truly material corrections, unless the fund has received "template filing" relief, the only alternative is to file an amendment under Rule 485(a), which will not become effective for sixty days (or a shorter waiting period, if the SEC staff is willing to expedite its review of the changes and accelerate the effectiveness of the amendment). In these circumstances, the fund may have to stop selling shares until the amendment is processed, in order to avoid liability under the Securities Act. When making interim amendments, counsel should bear in mind section 3-18(c) of Regulation S-X, which will require the addition of interim unaudited financial information if the audited financial statements are more than 245 days old on the effective date of the amendment.

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43. IM Guidance Update No. 2016-02, *supra* note 8.

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Less material corrections can be made immediately by a “template” or other amendment to the registration statement filed under Rule 485(b), if the change qualifies for filing under that Rule. In appropriate circumstances, they can also be made immediately by “supplementing” the prospectus or SAI with additional material (often in the form of a “sticker” that can be affixed to the prospectus or SAI) or printing a corrected prospectus or SAI (in which case the dating of the prospectus should be revised to indicate the original effective date, supplemented as of a later date). The supplement can be filed with the SEC pursuant to Rule 497(e) of the Securities Act, as a form of prospectus varying from the form filed under Rule 497(c) (or referred to in a certificate filed under Rule 497(j)) after the effective date of the registration statement.<sup>44</sup> A supplement to the summary prospectus portion of Part A must also supplement the summary prospectus when it is used alone as an offering document; the SEC staff has indicated that in such cases the summary prospectus may be reprinted even if the statutory prospectus is not.

As in the case of annual amendments to the fund’s registration statement, whether a correction is eligible for filing as an amendment under Rule 485(b) or as a supplement under Rule 497, or is so material that it must be filed under Rule 485(a), can be a difficult matter of professional judgment—and usually must be determined in the context of fund management’s desire to avoid any interruption in sales of fund shares. Little formal guidance about these judgments is available.

In its 1995 “generic comment letter”, the staff reminded registrants that “they may not materially alter the nature of the fund contemplated in the last pre-effective amendment by merely filing a Rule 497 . . . (c) prospectus that makes those material changes. For example, if a new fund designed to invest primarily in domestic equity securities, after the effective date of its registration statement but before the commencement of its public offering, changes its investment objective and policies so that it becomes an emerging markets fund, a post-effective amendment filed under Rule 485(a), rather than a Rule 497 prospectus, should be the vehicle for reflecting the change.”

In the case of disclosures regarding changes in portfolio managers, the Commission indicated that a supplement is appropriate, and could be sent to existing fund shareholders in the fund’s next regular mailing (or, if earlier, when the shareholder purchases

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44. If the form of prospectus filed under Rule 497(c) includes information in response to items 2–4 of Form N-1A that varies from the information in the registration statement as filed, then an interactive data supplement must also be filed. *See supra* section 4:3.9[C].

additional shares other than through a dividend reinvestment plan).<sup>45</sup>

The Commission has permitted information about new sub-advisers to be submitted as a supplement under Rule 497 by funds that have received exemption orders permitting the substitution of sub-advisers without shareholder vote (this is often accompanied by filing the year-end annual update amendment under Rule 485(a)). In its 2009 Release with respect to the summary prospectus, the Commission noted that if a fee waiver or expense reimbursement which was to be in effect for one year after the effective date of a prospectus is nonetheless terminated earlier, the fund would be required to supplement its prospectus under Rule 497 to reflect the termination.<sup>46</sup>

As in the case of annual amendments, the extreme cases are easy, the hard cases are in the gray area, and the Commission staff generally depends on counsel to make the call.

## § 4:5 Delivery Requirements

### § 4:5.1 Delivery of Preliminary Prospectus

Section 5(b) of the Securities Act prohibits the use of the mails or other means of interstate commerce to transmit a prospectus relating to fund shares for which a registration statement has been filed, unless the prospectus meets the requirements of section 10 of the Act. As the initial registration statement for a fund usually contains a number of blanks, it does not meet all of the disclosure requirements specified by the Commission pursuant to section 10(a) of the Act. However, section 10(b) of the Act authorizes the Commission to permit the use of prospectuses which omit some prospectus information, and the Commission has adopted Rule 430 to permit the distribution of “preliminary prospectuses” (including preliminary summary prospectuses) during the “waiting period” between the date the registration is filed and the date it becomes effective.

Rule 430 requires the preliminary prospectus to contain “substantially” all of the information required to be in a final prospectus. The Rule also specifically requires that funds using Form N-1A make a preliminary statement of additional information available upon request to persons receiving the preliminary prospectus. Rule 481 under the Act requires that any such prospectus or SAI indicate that

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45. Investment Company Act Release No. 19,382 (Apr. 6, 1993).

46. In the recent Charles Schwab Investment Management administrative proceeding, the Commission noted that the information about a change in a fund's industry concentration policy was not appropriate for a Rule 497 filing. *See supra* note 42.

it is subject to completion and may be changed, and that fund shares may not be sold until its registration statement is effective.

### § 4:5.2 **Delivery of Final Prospectus and Supplements**

#### **[A] Initial Delivery**

Section 5(b)(2) of the Securities Act provides that it is unlawful to use the mails or other means of interstate commerce to carry fund shares for the purpose of sale or delivery after sale, unless the shares are accompanied or preceded by a prospectus that meets the requirements of section 10 of the Act (a “final” prospectus that is included in a registration statement which has become effective). Thus, a final summary prospectus or statutory prospectus must be delivered to each purchaser of shares no later than the time a confirmation of his or her initial purchase of fund shares is delivered.<sup>47</sup>

Since a fund’s prospectus is normally updated annually, some procedure must be established to ensure that an effective updated summary or statutory prospectus is in the hands of existing fund shareholders before they purchase additional shares.<sup>48</sup> Rather than bearing the expense of sending a prospectus with each confirmation of a shareholder’s purchase of additional shares, most fund groups send copies of the fund’s new prospectus to all shareholders each time it is updated. In its 1991 generic comment letter, the Division of Investment Management confirmed that this procedure will satisfy the prospectus delivery requirements of the federal securities laws.

When a fund supplements its summary or statutory prospectus between normal annual updates, some procedure must also be used to make sure that the information is in the hands of current shareholders who purchase additional shares of the fund. This is usually done either by special mailing or by inclusion of the supplement information with the next shareholder report or confirmation, whichever is earlier.

The same principles apply to the delivery of final summary prospectuses, and updates and supplements to such prospectuses.

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47. For a discussion of the practical problems of maintaining an adequate number of prospectuses on hand to satisfy this requirement, see Wells Fargo Advisers, LLC, FINRA Letter of Acceptance, Waiver, and Consent, No. 20100229218 (Mar. 21, 2011).

48. Although dividend reinvestment shares are included in calculating the annual registration fee under Rule 24f-2, the Commission has a long-standing position that shares purchased pursuant to a dividend reinvestment plan are not treated as “sales” of stock for purposes of registration requirements under the Securities Act. Securities Act Release No. 929 (July 29, 1936). Thus, shareholders who only purchase additional shares through such a plan need not receive an updated prospectus.

**[B] Summary Prospectus: Accessibility of Statutory Prospectus, SAI, and Shareholder Reports**

Rule 498 provides that if a fund elects to rely on a summary prospectus to meet its Securities Act prospectus delivery obligations, the fund's current summary prospectus, SAI, and most recent annual and semi-annual reports to shareholders must be accessible, free of charge, at an Internet website address specified in the summary prospectus.

A variety of technical requirements apply to the nature of the electronic accessibility of these materials. The Internet address must lead directly to the materials rather than to a home page or other section of the website on which the materials are posted, although a central site with prominent links to each incorporated document is permissible. The materials must be accessible on or before the date the summary prospectus is sent or given, and must remain accessible for at least ninety days after the carrying or delivery of a security, or a communication related to an offering, that is preceded or accompanied by the summary prospectus that is relied upon to meet the delivery requirements under section 5 of the Securities Act. The materials must be convenient for both reading online and printing on paper, and persons accessing the materials must be able to permanently retain an electronic version of them free of charge. Links must be provided to permit movement between each section of the summary prospectus and the tables of contents of the full statutory prospectus and SAI that provide additional detail regarding that section of the summary prospectus (or directly between each section of the summary prospectus and any portions of the full statutory prospectus and SAI that provide additional detail regarding that section of the summary prospectus), and to permit movement directly back and forth between each item listed in the table of contents of the full statutory prospectus or SAI, and the substantive sections of the item in the prospectus or SAI. Commission staff review websites to check compliance with these technical requirements.

**[C] Summary Prospectus: Delivery of Statutory Prospectus upon Request**

Rule 498 requires a fund using a summary prospectus (or a financial intermediary through which fund shares may be purchased or sold) to send a paper copy of the statutory prospectus, SAI, and most recent annual and semi-annual shareholder reports to any person requesting the same, within three days after the request and at no cost to the requester. In addition, as these documents are required to be accessible

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electronically, the proposed amendments require the fund to email a copy to any person requesting such delivery within the same period at no cost to the requester.

The Commission staff noted in a letter to the Investment Company Institute with respect to a now-superseded form of summary “prospectus profile”<sup>49</sup> that “[w]hen a financial intermediary is named in the prospectus (or profile) as a party to contact in order to obtain information or when a financial intermediary otherwise acts as an agent for a fund, the fund remains obligated to ensure that the information is sent to investors within three business days of receipt of a request. In those cases, the fund can contract with intermediaries to ensure their compliance with the three-day mailing requirement.” The same letter indicates that a fund is not responsible for ensuring such delivery if the third-party intermediary is not an agent of the fund, the prospectus or profile provides a toll-free or collect phone number for investors to call to obtain a copy from the fund, the prospectus or profile does not mention the intermediary as a source for obtaining such documents and does not generally instruct investors to contact an intermediary to obtain documents, and the investor directly contacts the third-party intermediary to request the documents.

#### § 4:6 Use of Electronic Media

With the exception of access to the proposed summary prospectus and related documents and the filing of interactive data exhibits, federal securities laws do not prescribe any specific medium for providing required information to purchasers or prospective purchasers, and the SEC has indicated that delivery of information through electronic media can satisfy delivery requirements. Any document delivered electronically must be prepared, updated and delivered in compliance with federal securities laws, and must contain all of the information otherwise required, in substantially the same order and manner as a paper document. The SEC’s general views on these matters are set forth in a series of releases.<sup>50</sup>

As discussed above, Rule 498 under the Securities Act with respect to a fund’s use of summary prospectuses requires the fund to provide investors with electronic access to the summary prospectus and to underlying fund registration and shareholder report documents, and to provide paper and electronic copies of those documents upon request.

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49. Letter from Barry D. Miller, Associate Director of the Division of Investment Management, to Craig S. Tyle, General Counsel of the Investment Company Institute (Oct. 2, 1998).

50. See Investment Company Act Release Nos. 21,399 (Oct. 6, 1995), 21,945 (May 9, 1996), 24,426 (Apr. 28, 2000).



However, initial delivery of a summary prospectus electronically is governed by the same general views discussed below.<sup>51</sup>

**§ 4:6.1 Consent to Electronic Delivery**

Electronic delivery is not valid unless the recipient has given informed consent to such delivery. Informed consent requires notice of which electronic media will be used (for example, consent to email delivery does not consent to web access delivery), the costs associated with electronic delivery (such as fees for online connection time), and whether the consent continues indefinitely and extends to more than one type of document.<sup>52</sup> The investor may consent in written or electronic form, including telephonic consent (through automated phone systems or in a call by a client to a broker-dealer who knows the client well). Issuers and market intermediaries must obtain consent in a manner that assures its authenticity, and a record of the consent must be generated and retained. An investor may provide a “global” consent to electronic delivery of all of a fund’s disclosure documents, so long as the nature of the consent is adequately called to the investor’s attention.

An investor may revoke consent to electronic delivery at any time. In addition, regardless of such consent, an investor may request paper delivery at any time, within the time delivery period discussed above.

**§ 4:6.2 Notice, Access, and Proof of Delivery**

Electronic delivery of a required disclosure document must provide at least the same notice as paper delivery that the information is available. If the document is delivered electronically directly to an investor’s email address, then the act of receiving the document provides the same type of notice as delivery to the investor by U.S. mail. If the electronic delivery is indirect, such as through posting on a web page, then additional steps are required to ensure adequate notice that the information exists. These additional steps can include direct email to the investor, paper notice by mail, or other methods that provide reasonable notice of the existence and location of the information.

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51. See Investment Company Act Release No. 28,584, at n.197 (Jan. 13, 2009).

52. It is not clear whether previous consent to electronic delivery of a statutory prospectus is adequate to cover such delivery of a summary prospectus. Some funds have interpreted both as a single “type of document” and others have treated them as separate “types” and obtained new consents for summary prospectuses.

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As with documents delivered in paper form, the recipient of an electronically delivered document must have an easy method to access the information sent, without undue burdens and with the prospect of some degree of permanence. To ensure easy access, websites should be simple and user-friendly. In this regard, the Commission has indicated that passwords will not be deemed unduly burdensome, and that documents may be delivered in portable document format (PDF) even if the investor needs to have Adobe Acrobat software to view the material, so long as investors are provided with free access to the necessary software and technical assistance. To ensure a degree of permanence, investors must be able to directly download the online document or access the document on an ongoing basis for as long as the delivery requirement applies.

A record of direct electronic delivery will satisfy the fund's burden of proving delivery if the recipient has agreed to such delivery. However, posting of a document on a website does not prove that the document has been delivered unless appropriate notice of the posting is provided and the recipient has agreed to such delivery. Other methods of proof of delivery include:

- Use of an electronic profile application, if both the profile and the prospectus are available at the same electronic site.
- An email return receipt, server log or other evidence that an investor accessed, downloaded or printed the required information.
- Dissemination of a document by fax.
- Information provided by an investor during online access, such as a fax number and evidence of a subsequent fax to that number.
- Use of forms or other materials available only by accessing the electronic information.

### **§ 4:6.3     *Hyperlinks***

A fund that embeds a hyperlink in a document that is required to be filed with the SEC or to be delivered under federal securities laws will be deemed to have adopted the hyperlinked information. Hyperlinks from a profile to a full prospectus, for example, can facilitate an investor's ability to obtain prospectus information. In view of the potential liabilities involved, however, hyperlinks in basic disclosure documents should be used only with great care.