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Attorneys Look to SEC for Disclosure Relief

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Recent testimony by SEC chairman Christopher Cox has revved up the fund industry's desire to have disclosure requirements revamped. At the same time, mutual fund attorneys are calling for the SEC to create a safe harbor provision for firms that provide simplified prospectuses for investors.

In a presentation before the Senate Committee on Banking, Housing, and Urban Affairs on Tuesday, Cox renewed his call for simplified disclosure documents that retail investors can easily understand. Cox also called for the industry to move away from providing long, hard-to-read disclosure documents and instead provide easy-to-navigate Web pages.

Mutual fund attorneys maintain that the SEC has been pushing for plain English disclosure for years. Yet, few fund firms will make changes without having incentives to do so.

"The idea has always been to keep things plain and simple," says Joseph Del Raso, a partner at law firm **Pepper Hamilton**. "But it just never gets done."

The problem is that fund firms want to disclose all possible risks associated with funds as well as fees and other information. That way they can say fees and risk were adequately disclosed in the event they face litigation from unhappy shareholders or scrutiny from regulators.

"The SEC is still going to want to hold someone's feet to the fire," he says.

With that in mind, the SEC should evaluate creating a safe harbor provision for fund firms that offer simplified prospectuses, he says. Safe harbors are provisions that specify that firms won't be in violation of specific regulations if they meet certain requirements.

In this case, for example, firms could rest assured that simplified prospectuses have met SEC requirements if they complied with guidelines found within a safe harbor provision.

Without such a safe harbor, fund firms and their attorneys will continue to produce complicated disclosure documents. Fund firms have been fighting off a variety of lawsuits alleging excessive fees, improper disclosures of revenue-sharing arrangements and harm to shareholders from market-timing activities, points out Victor Siclari, a partner with **Reed Smith**.

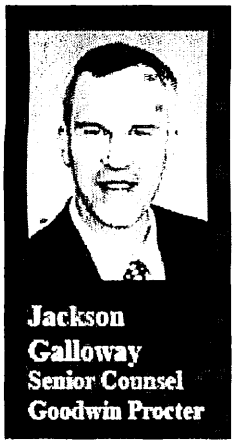
"Those problems are all requiring firms to increase disclosure," he maintains. He believes fund firms will continue to err on the side of caution by ensuring that their prospectuses and other documents are adequate.

Fund firms want to leave little room for doubt regarding the appropriateness of disclosures in fund documents. Indeed, simply being able to win litigation launched by unhappy shareholders isn't sufficient. Rather, fund shops want to preempt litigation, as conducting legal defenses against lawsuits can be a costly matter.

A safe harbor provision could help address that problem, however.

"If the SEC provides incentives for fund firms to make disclosures shorter, then I think fund firms would embrace it," Siclari says.

Rather than seeking ways for fund firms to shorten prospectuses, the SEC has been moving in the opposite direction,



adds Jackson Galloway, senior counsel with **Goodwin Procter**. Over the past few years, for example, the SEC has implemented new rules requiring firms to increase disclosures on soft dollars, revenue sharing and the renewing of contracts with fund advisors.

Cox, however, has been frequently promoting the need for prospectuses to be easy to understand. "It seems that the SEC is building up momentum to do something regarding disclosure regulations," Galloway says.

Cox has also worked to promote the use of the Internet to improve disclosures for fund shareholders. Siclari says he's cautious about the concept. "In my mind it would be more helpful for institutional investors than individuals," he says.

Not all households have Internet access, he points out. As a result, fund firms will probably end up developing two sets of disclosures. One set will be for online use and the other will be paper-based for individuals who lack Internet access. That could result in increased costs, as fund firms would have to create two sets of disclosure documents.

The SEC is also promoting the use of XBRL. The technology involves inserting data tags into disclosure documents. Those tags then allow search engines or other types of software programs to extract data for research purposes.

"I would hope that the commission will consider the costs of that before it requires fund firms to adopt it," Galloway says.

One encouraging feature of the Cox presentation was that the chairman didn't focus on new mutual fund issues, says Niels Holch, executive director of the Coalition of Mutual Fund Investors. Indeed, most of his comments focused on issues involving operating companies rather than mutual funds.

"I guess I look at it as the glass being half full," he says.