Opinion

E-Delivery Should Help Investors, Not Financial Intermediaries

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Editor's Note: This is the second of two opinions that focus on the most recent proposals to encourage e-delivery of shareholder reports. This column addresses some of the regulatory concerns. Yesterday's column looked at some of the operational issues surrounding e-delivery and summary disclosures. Ignites *reached out to Broadridge, and the firm did not have an immediate comment.*

Electronic communications are rapidly replacing paper documents and distribution arrangements that rely on the U.S. mail. The mutual fund industry is no different.

Fund shops are required to provide investors with periodic shareholder reports. The industry would like to move away from a paper-based system that is expensive to operate, to an electronic method that is not as cumbersome.

However, one proposal being considered by the SEC's Investor Advisory Committee is inadequate, and stands to benefit one company: Broadridge Financial Solutions. In October, the firm proposed an e-delivery prototype to the committee, dubbed "enhanced notice." Though the name of the company has been deleted in the latest version of the Investor Advisory Committee's proposal, there is still an effort under way to increase the role of broker-dealers and other financial intermediaries in any new e-delivery rule.

Anything the Securities and Exchange Commission decides to authorize should favor investor interests. It should not establish new revenue opportunities for financial intermediaries.

The Initial Proposal

In 2015, the SEC proposed a package of amendments to its existing rules that included a plan to permit fund shops to post online their annual and semi-annual shareholder reports, instead of sending them to investors in the mail. Shareholders would have been notified that the default delivery method had changed to e-mail, and would then have been required to contact their fund companies if they wanted to continue receiving shareholder reports in paper form.

This 2015 proposal would have worked in a similar fashion to the "notice and access" method used by public companies for distributing proxy materials. However, it was ultimately left on the cutting room floor after facing stiff resistance from consumer advocates and, not surprisingly, the paper industry.

Another issue lies in investor access to these reports. Although many shareholders actively use the Internet to monitor their investments, a significant number of investors can't. For example, 14% of investors ages 65 or older don't have Internet access, according to data from the Investment Company Institute.

The Latest Versions

After several years of public debate on this topic, the SEC's Investor Advisory Committee is considering a compromise.

Under the proposal that the SEC Investor Advisory Committee considered at its Oct. 12 meeting, investors would be notified via snail mail that their shareholder reports are available for review online, accompanied by a summary of the underlying document. The full report would then be available online for investors seeking additional information.

Broadridge developed a prototype of this summary notice and presented it to the SEC Investor Advisory Committee during this October meeting. The committee initially referenced Broadridge in a draft recommendation to the agency, but was criticized for this by the Investment Company Institute.

More recently, the Investor Advisory Committee released a revised recommendation, which dropped any mention of the firm. However, this new version continues to endorse a summary notice of the kind that Broadridge proposed, and the language of the recommendation is vague on the role of financial intermediaries in providing access to fund documents.

There Are Some Good Parts …

Certain elements of this proposal make sense. For example, individual investors do not typically read lengthy disclosure documents. The mutual fund industry has led the financial services industry in offering "layered" disclosures. In these cases, short summary documents are sent to investors, with more details available online. These disclosures are more meaningful to investors because they highlight only the most important information.

Under this new approach, investors could still receive information about their funds through snail mail, and review the highlights of each shareholder report. If they are interested in obtaining more information, they could then access the full report on their mutual fund's website. This process is identical to how investors currently access statutory prospectuses or statements of additional information.

The fund industry would also be able to reduce its mailing expenses. It costs the industry $308 million per year to print and deliver these documents, the ICI estimates. Investors could also limit the amount of material in their recycling bins each week. Two million trees are killed each year to print 240 million shareholder reports, the ICI says.

... But Certain Provisions Need Further Work

Any new e-delivery proposal should be designed to be in the best interests of the individual investor. As it currently stands, this Investor Advisory Committee proposal does not meet this test.

*S*hareholder Consent Should Not Be Forced

The SEC's original proposal would have switched the default delivery method to an electronic one, and investors would have had to expressly revoke this implied consent to continue receiving shareholder reports in paper form.

SEC rules should not be changed to force investors to take an affirmative action to retain the status quo. Instead, any change to e-delivery should only occur with each investor's voluntary consent. In other words, the default delivery method should be paper, unless the investor explicitly decides otherwise.

Fund Notices Should Include a Summary Report

The Investor Advisory Committee proposal to develop a summary shareholder report is on the right track. A document that provides investors with highlights of the shareholder report could be a significant improvement over the existing system. This summary report would include a notice that the full report is available online.

The industry should embrace this layered approach to providing shareholder reports to investors. Fund data is very standardized. Fund shops should develop a format for summary shareholder reports that would highlight the most important information in a manner that has a better chance of being noticed than the current, long disclosure documents.

Reports Should Be Available on Each Fund's Website — and Only There

Investors should be able to continue to access all fund disclosure documents on each mutual fund's website, as they can do today. These websites already contain PDFs of prospectuses, shareholder reports and statements of additional information. There is no reason to build a new mechanism for Internet access to these documents.

However, Broadridge's proposal that was aired during the October meeting of the SEC Investor Advisory Committee would place these disclosure materials on a central website presumably owned and operated by Broadridge. The firm is already the primary distribution agent for shareholder materials and providing it with a larger role is a step backward from the current system. Shareholder reports do not need to be available on a third-party website. A financial intermediary, such as a broker-dealer, should be able to link to these documents on each mutual fund's website as a service to its customers. But the SEC should not permit any financial intermediary to control the dissemination of these reports.

There is no need for a central repository for these documents, and the cost of establishing and operating an intermediary-controlled website would be borne by investors who are not asking for this service. If the SEC moves forward with a revised e-delivery proposal, it should focus exclusively on the needs of individual fund investors, and not create new business opportunities for financial intermediaries.