Consumer Federation of America

December 15, 2020

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE, Washington, DC 20549-1090

Re: File No. S7-09-20, Mutual Fund Disclosure Modernization

Dear Secretary Countryman:

I am writing on behalf of the Consumer Federation of America (CFA)[1] in response to the Commission's proposal to modernize the disclosure framework for mutual funds.[2] We will later submit a letter that goes into more detail regarding the proposal to create tailored shareholder reports highlighting "key information that is particularly important for retail investors to assess and monitor their fund investments," which we generally support. In the meantime, this letter responds to an issue that has arisen in the context of that rulemaking – a proposal from a number of industry groups to "update" Commission policy regarding electronic delivery of disclosures by switching the default to electronic delivery for anyone who has provided their securities firm or professional with an email address or smartphone number.[3] We oppose that proposal.

We agree that the time is right for the Commission to begin to reconsider its approach to disclosure in the digital age. After all, no discussion of the modernization of the disclosure framework would be complete without a consideration of how we can use the power of

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[1] Consumer Federation of America is an association of more than 250 national, state, and local pro-consumer organizations founded in 1968 to advance the consumer interest through research, advocacy, and education.
[2] Securities and Exchange Commission, Proposed Rule, Tailored Shareholder Reports, Treatment of Annual Prospectus Updates for Existing Investors, and Improved Fee and Risk Disclosure for Mutual Funds and Exchange-Traded Funds; Fee Information in Investment Company Advertisements, File No. S7-09-20 (Aug. 5, 2020), https://www.sec.gov/rules/proposed/2020/33-10814.pdf.
[3] *See, e.g.,* David Isenberg, Clayton Calls for E-Delivery Expansion, Ignites (Nov. 3, 2020), https://bit.ly/3mnDzDZ. *See, also,* SIFMA, SIFMA Asset Management Group, Financial Services Institute, and Investment Adviser Association, E-Delivery: Modernizing the Regulatory Communications Framework to Meet Investor Needs for the 21st Century (Sep. 2020), https://www.sifma.org/wp-content/uploads/2020/09/E-Delivery-Paper.pdf; Letter from Fidelity Investments, The Charles Schwab Corporation, and BlackRock, Inc., to SEC Chairman Jay Clayton (Sep. 8, 2020), https://www.fidelity.com/bin-public/060_www_fidelity_com/documents/about-fidelity/digital-delivery-letter.pdf.

technology to transform the way we deliver information to investors. But simply changing the default for how disclosures are delivered from paper to digital is unlikely to deliver the potential benefits to investors of a technology-enabled approach to disclosure. If investors, and not just industry, are to benefit from a move to greater reliance on digital disclosure, we must reimagine our approach not just to the delivery mechanism but also to the disclosures themselves in light of the capabilities unlocked through electronic delivery (e-delivery).

If the Commission were to adopt the approach outlined by these groups, it would waste this opportunity to deliver that more extensive and potentially more creative re-imagining of our disclosures for the digital age. Instead of rushing to change the default, the Commission should conduct a more thorough analysis of the issue in order to ensure that the evolution toward greater reliance on e-delivery occurs on terms that are most favorable to investors and not just those that are most convenient for industry. That is a standard the current proposal from industry groups does not meet. Moreover, experience has taught us that if we give industry what they want (in this case a digital default) without tying it to changes that benefit investors (timelier delivery of more investor-friendly disclosures), investors are likely to wait in vain for the Commission to act on their priorities.

We therefore urge the Commission to shelve the current industry proposal to move to a digital default until it can be considered as part of a broader disclosure modernization project. That project, which we encourage the Commission to undertake, should be driven by data regarding investor preferences and by analysis of what works to improve investor engagement with disclosures, and not by blind faith that "if you build it, they will come."

There is no Urgent Need for the Commission to Act

The good news is that there is no urgency to act on the industry request to change the default to digital. As they themselves document, the current policies on e-delivery have enabled investors who prefer to receive disclosures electronically to do so with a minimum of inconvenience. And, the number of investors who choose to do so continues to rise at a steady pace. The big "impediment" industry groups cite is the requirement, under the E-Sign Act, to verify through electronic means the investor's preference for electronic delivery. However, as we and 34 other consumer groups argued in a letter opposing legislation to "modernize" the E-Sign Act along the lines industry is seeking, this verification requirement is designed to ensure that consumers will actually be able to access and save electronic records containing important information through different electronic mechanisms.[4] It is hardly burdensome. It can be satisfied simply by having the consumer wait for an email or text and click on a link.

In making their case for a digital default that would be triggered by nothing more than the individual's providing the firm with a digital means of communication, industry groups claim that this confirmation requirement is so confusing to investors that it should be eliminated. But an investor who is confused by this requirement, which is easily

[4] Letter from Americans for Financial Reform *et al* to Senator John Thune, opposing S. 4159, the E-SIGN Modernization Act of 2020 (Sep. 10, 2020), https://www.nclc.org/images/pdf/legislation/E-Sign-S.-4159-Thune-Oppose.pdf.

communicated and simple to execute, is probably not well-suited to receive disclosures electronically. This verification requirement is far less prone to misinterpretation than the industry groups' proposed approach of having the simple act of providing a mobile phone number or email address denote election of e-delivery for all disclosure documents. At the very least, the Commission should require more evidence that a problem exists, and more evidence that the proposed approach would be clearly understood by investors, before changing a policy that is working well to ensure that all investors receive disclosures in their preferred format.

Industry groups have sought to create a sense of urgency for Commission action by presenting a distorted picture of the evidence.

- **They greatly exaggerate the degree of investor preference for e-delivery**, equating investors' desire for access to information online and comfort using the Internet for a variety of purposes with a preference for e-delivery. In fact, survey data suggests that, while the percentage of investors who prefer various means of electronic delivery continues to grow steadily, a significant percentage of investors continue to prefer paper delivery. According to FINRA Education Foundation's 2018 survey, for example, more investors (36%) prefer receiving disclosures in the form of paper documents physically mailed to them than prefer to receive them electronically by email (33%). Another 9% want to receive them on the Internet, not via email. Among investors 55 and older, 42% prefer paper delivery, compared with 30% who prefer to receive documents electronically by email.[5] In short, the existing policies on e-delivery are already producing investor election of electronic delivery that closely matches, or exceeds, their stated preferences.

- **They ignore risks associated with e-delivery.** Industry advocates of changing the default to e-delivery repeatedly argue that e-delivery is "safer" than mail delivery. But they fail to acknowledge the risks associated with phishing attacks on individuals and security breaches at financial firms. While many financial firms have taken extensive steps to protect the sensitive financial data entrusted to their care, they are not immune from cyber-attacks.[6] The impact on investors, who may have to repeatedly change user IDs and passwords to access their data, can be significant. Meanwhile, investors who are expecting to receive disclosures via email, and to click on links in those emails to access their documents, may be more vulnerable to phishing attacks, which have become increasingly sophisticated.[7] Similarly, while advocates cite the potential for disruptions to mail delivery, they fail to acknowledge the far more common

[5] Investors in the United States–A Report of the National Financial Capability Study, FINRA Investor Education Foundation (2019), at https://www.usfinancialcapability.org/downloads/NFCS_2018_Inv_Survey_Full_Report.pdf.

[6] "More than 60% of All Leaked Records Exposed by Financial Services Firms," Security Magazine (Dec. 16, 2019), https://bit.ly/3oew9TT. Citing the 2019 Financial Breach Report by Bitglass, the article notes that, "Many financial services organizations are still not taking proper steps to secure data in our modern cloud and BYOD environment."

[7] Aaron Holmes, Hackers are getting better at tricking people into handing over passwords — here's what to look out for, according to experts, Business Insider (Jul. 18, 2020), https://bit.ly/3g1oDsA.

disruptions that can occur when financial firms suffer website outages, often at times of extreme market volatility, when investors are most anxious to gain access to their accounts.[8] Any switch to e-delivery needs to be carefully designed to minimize those risks.

- **They exaggerate the benefits of better investor engagement from e-delivery.** We agree that a creative, well thought out approach to electronic disclosure has the potential to improve investor engagement with, and understanding of, disclosures. But simply delivering disclosures electronically does not guarantee those benefits. Ultimately, unless we rethink our approach to disclosure to take advantage of the potential that e-delivery can provide, there is no reason to believe that simply changing the delivery mechanism will lead to better investor engagement with disclosure. On the contrary, if it is approached in a way that makes it less likely investors will see and read those disclosures, it could just as easily have the opposite effect. At the very least, the Commission should examine the issue more carefully before acting, with a particular focus on what characteristics are effective in promoting better investor engagement and what are likely to detract from disclosure effectiveness. The measure of disclosure effectiveness should be whether investors are more likely to view *and understand* the information provided, not just whether they like the bells and whistles that internet disclosure can provide.

- **They ignore investor opposition to the types of changes they advocate.** Industry groups cite both the Department of Labor's recent rule change to default to electronic delivery of retirement account disclosures and the SEC's earlier Rule 30e-3 rule change as policy "advances," without acknowledging that both moves were made over strong objections from investors and workers.[9] Similarly, even as they cite the SEC Investor Advisory Committee's (IAC) general support for further advances in digital disclosure, they fail to acknowledge the IAC's opposition to approaches, such as that adopted in Rule 30e-3, that fail to respect investor preferences and reduce the likelihood that investors will see and read important disclosure documents.[10]

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[8] *See, e.g.,* Daisy Maxey and Sarah Krouse, Investment Firms Suffer Website Outages, The Wall Street Journal (Feb. 5, 2018), https://www.wsj.com/articles/investment-firms-suffered-website-outages-monday-1517868286.

[9] A review of comments on the DOL proposal (available here: https://www.dol.gov/agencies/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB90) shows hundreds of largely negative comments from individual workers as well as opposition letters from a variety of advocacy groups, including CFA, AARP, National Consumer Law Center, the Alliance for Retired Americans, Consumer Action, Public Citizen, National Consumers League, and more. *See, also,* April 12, 2016 letter from Consumer Action Director of National Priorities Linda Sherry and National Consumers League Executive Director Sally Greenberg to SEC Secretary Brent J. Fields, regarding Investment Company Reporting Modernization Proposed Rule; Release Nos. 33-9776; 34-75002; IC-31610; File No. S7-08-15; S7-16-15 http://bit.ly/2vFQk67; and July 29, 2015 letter from CFA Director of Investor Protection Barbara Roper to SEC Secretary Brent J. Fields, regarding Investment Company Reporting Modernization, File No. S7-08-15 http://bit.ly/2vGd463.

[10] Recommendation of the Investor Advisory Committee Regarding Promotion of Electronic Delivery and Development of a Summary Disclosure Document for Delivery of Investment Company Shareholder Reports (Dec. 7, 2017), https://www.sec.gov/spotlight/investor-advisory-committee-2012/recommendation-promotion-of-electronic-delivery-and-development.pdf. ("In May 2015, the Commission proposed Rule 30e-3 to allow mutual fund companies to default investors to electronic delivery of annual shareholder reports based on

Industry's Proposed Approach Suffers from Significant Flaws

Beyond their unfounded claims about the need for a change in policy, the industry groups' proposed approach suffers from several fatal flaws. The first is that it would default investors to e-delivery at account opening simply by virtue of the investor's providing the firm with a mobile phone number or email account. The burden would be on the investor who prefers paper delivery to take affirmative steps to change that delivery "selection," a selection they may not realize they've made, and firms would have no incentive to encourage them to do so. As noted above, this approach is likely to be far more confusing to investors than the fairly straightforward requirement to verify the choice to receive disclosures electronically by clicking on a link in an email or through a similar mechanism on the firm's website. As a result, this approach would be guaranteed to result in a certain number of investors being opted into e-delivery who would prefer paper delivery.[11] While we appreciate the development by some industry groups of basic investor protection principles as a partial step to address this risk, those principles are not sufficient to overcome the fundamental inequity of defaulting investors to digital delivery based on what may be an entirely unrelated decision by the investor to provide the firm with a digital form of contact.[12]

This feature of the industry proposal is also entirely unnecessary. A far more sensible approach would be to eliminate the default entirely at account opening, give investors a clear choice, and allow (or require) them to select their preferred delivery method at that time. Ideally, they would be able to choose different delivery methods for different types of documents (e.g., opting for electronic delivery of prospectuses and shareholder reports, but choosing paper delivery for account statements). And, of course, they should have an easily accessible and easy-to-use mechanism for changing that selection at any time. Such an approach would do what industry groups say they want to do, which is to treat paper and electronic delivery as equally valid options. Given the relatively even divide between investors who prefer paper delivery and those who prefer e-delivery, that sort of equal treatment is far more appropriate than the industry's proposed approach, which would strongly favor electronic over paper delivery.

It is even more egregious that industry groups propose to switch existing clients who receive disclosures in paper format – either by choice or through default – based on nothing more than their having at some point provided the firm with a form of digital contact, such as a mobile phone number or email address. Even if they haven't directly elected paper delivery,

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negative consent. While the proposal enjoyed strong support from the fund industry, who noted its potential to reduce costs, it met with significant resistance from investor advocates, who maintained that an approach that relies on website disclosure and negative consent would reduce the likelihood that investors would see and read the disclosure documents.")

[11] As we have argued elsewhere, one reason the current system works so well is that firms are motivated to overcome investor inertia in order to get them to switch from paper to e-delivery. They will have no such incentive to ensure that investors who would prefer paper delivery make that selection.

[12] *See, e.g.,* the 5 Digital Delivery Investor Protection Principles included in the Fidelity, Schwab, and Blackrock letter.

these clients have likely passed up numerous opportunities to switch to electronic delivery. Industry groups would like to attribute this to simple inertia, and inertia likely plays a part. But, at a certain point, when the customer has passed up numerous opportunities to switch, that begins to look a lot like a choice, and investor choice should be respected.

It is particularly problematic that simply providing a mobile phone number would be enough to trigger the conversion to e-delivery. The fact that someone may want to periodically speak to their broker or adviser over the phone, and provides them with their cellphone number in order to do so, does not mean they want to receive notice of disclosures via text. Those who want to receive such notices via text should be free to elect to do so, and nothing in our current rules prevent that, but those who do not want to receive disclosures in this form should not have to jump through additional hoops to continue to receive disclosures in their preferred format.

When the ability of investors to receive important information in their preferred format is at stake, there should be an extremely high bar for eliminating the requirement for affirmative consent. The advocates of this approach have not met that bar. They have not shown that their proposed approach would be as effective as the current policies in ensuring that investors receive disclosures in their preferred format. Nor have they shown that current policies are impeding the transition to e-delivery. On the contrary, they have demonstrated that firms have succeeded in getting a significant and growing majority of investors to make that transition under the existing rules. It appears that their real frustration is not with the current rules' "cumbersome" requirements, but with the stubborn insistence of some investors on continuing to receive disclosures in paper, through the mail. That is not an adequate reason to change policies that have worked well for decades.

The Commission Should Undertake a Comprehensive Review Before Acting

Despite our strong opposition to the industry's proposed approach, we agree that the time is right for the Commission to undertake a comprehensive review of how the potential for electronic delivery could transform its approach to disclosure. This review should focus not just on the narrow issue of the delivery default, but also on broader questions of how electronic means of disclosure can enhance disclosure quality and investor engagement with and understanding of disclosures. That review should also include a review of potential impediments to investor selection of electronic delivery.

For example, industry groups tout the ease of access for digitally delivered disclosures. But, if investors need to sign into their account to access those documents, and remember their username and password to do so, some may view this as a significant impediment. They may respond by adopting lax security measures (using the same username and password across multiple accounts, for example, or using passwords that are easy to decode) in order to reduce the frustration. By contrast, all an investor has to do with paper disclosures delivered by mail is slit open the envelope and start reading. That may be one reason so many older investors prefer paper delivery. The Commission needs to do more

analysis to determine the factors that deter investors from selecting e-delivery in order to design an approach that can effectively address those concerns.

As the Commission considers how to adopt disclosures for a digital age, it should also consider the question of disclosure timing. For decades, investors have argued that the current rules on timing of disclosures result in their arriving too late in the decision-making process to be of value.[13] Industry groups have long opposed investors' efforts to require disclosures to be delivered at the point that a recommendation is made, arguing that it would be too costly and would needlessly slow the investment process. Electronic delivery, with its potential for virtually instantaneous and much less costly delivery of disclosures, should largely eliminate that concern. Modernizing disclosures for the digital age should therefore include revisions to the rules regarding timing of disclosures, so that investors finally receive the key information they need to make an informed selection of financial professionals or investment products at a time when that information can be factored into the decision.

Finally, while digital delivery has the potential to improve disclosure effectiveness, investors won't automatically reap those benefits just because disclosures are delivered digitally. In particular, investors are unlikely to reap the benefits of e-delivery if the disclosures themselves continue to be designed as paper documents. The Commission needs to put greater thought on the front end into the effective design of electronic disclosures. For example:

- One key question is what constitutes "delivery" in a digital world. Some in the industry have long argued for an access equals delivery approach to online disclosure, an approach that is strongly opposed by investors, as it seriously diminishes the likelihood that investors will see and read the disclosures. The Commission must retain a delivery requirement and carefully evaluate what practices satisfy delivery in this context. Allowing a text or email to provide notice that a disclosure is available, without also requiring inclusion of a hyperlink or url to take the investor to the relevant information (as the Commission permitted in its crowdfunding rules), should *not* be deemed to satisfy the delivery requirement.

- Electronic delivery allows for effective use of layering to present information at a level of detail appropriate to the investor. The current proposal for a tailored shareholder report is a good example of that. In other areas, however, the Commission can and should think more creatively about how to present information in a way that helps guide the investor through an investment decision.[14] Rethinking its approach to

[13] A recent example is the delivery requirement for Form CRS for broker-dealers, which does not have to be delivered until an investment recommendation is made, which comes *after* the investor has decided who to rely on for recommendations. Key aspects of Reg. BI's required disclosures on costs and conflicts can similarly be delayed until after an investment decision has been made as long as boilerplate disclosures are provided in advance.

[14] *See, e.g.,* Comment Letter from Barbara Roper and Micah Hauptman, Consumer Federation of America, regarding File No. S7-23-18, Updated Disclosure Requirements and Summary Prospectus for Variable Annuity and Variable Life Insurance Contracts (Feb. 27, 2019), at 2-6, https://www.sec.gov/comments/s7-23-18/s72318-4987088-182627.pdf (discussing an alternative approach to layered disclosure that we believe would be more

layered disclosure should be part of the Commission's consideration of how to modernize its approach to disclosure for the digital age.

- The Commission must recognize that the same features that enable digital delivery to make disclosures more engaging could also be used to bury or distract from important information that a firm doesn't want the investor to see (such as costs at a high-cost mutual fund). In developing a comprehensive approach to digital disclosure, the Commission will need to evaluate what features lead to effective disclosures and improved investor engagement, and what features detract from that goal, and design its approach accordingly.

- Industry touts the eased storage of and access to disclosures associated with e-delivery. But in a paper world, investors can decide for themselves how long they want to retain various records. What rules will apply with regard to how long firms must preserve investor access to disclosures? What assurances will investors have that important records – such as their account statements – will still be accessible years later, should the investor need them? How will that work when an investor decides to move their account?

- Different digital delivery methods – including email delivery, posting material on the firm's website, sending texts to a smartphone, or using a phone app – have very different characteristics. They are likely to pose very different risks, and offer very different potential benefits, to the user. Are disclosures readable in all these formats? Are there security risks associated with certain delivery methods that aren't present in others and that may therefore need to be accompanied by additional safeguards? What does investor testing tell us about the relative effectiveness and usability of these various methods?

- Tagging of data in electronic disclosures makes it easier to customize those disclosures for a particular investment. For example, with effective use of tagging, a broker recommending a mutual fund to a retail investor could provide the information specific to the share class being recommended to the investor, rather than requiring them to dig through irrelevant information to find the information that pertains to them. Tagging offers additional benefits if third parties are able to use that data to provide tools and analysis that presents information, such as BrokerCheck and IAPD records, in a more user-friendly fashion. These are just a few examples. The Commission should thoroughly evaluate how data tagging could be used to create more effective disclosures and information tools as part of its modernization project.

- For a generation that seems to learn everything via YouTube, the potential for video presentations to satisfy disclosure obligations represents an exciting possibility. But it will require careful thought on the part of the Commission to determine how the rules

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useful to investors than the current approach reflected in the new summary document for variable products and the summary prospectus for mutual funds).

may need to be adjusted to allow for this approach and to ensure that it meets appropriate standards for clarity.

For all of these issues, a robust program of investor testing can help to ensure that digital disclosures are developed in a way that maximizes their utility and effectiveness for investors and minimizes the risks. As it implements policy changes to promote electronic delivery, the Commission should continue to engage in testing to determine whether it achieves the goal of promoting better investor engagement or, like the conversion to e-delivery in the proxy voting context, has the unintended consequence of diminishing investor engagement. That concern, which is casually brushed aside by industry advocates of a digital default, deserves much more careful scrutiny than it has so far received.

Conclusion

For all these reasons, the Commission should stop and conduct a thoughtful, comprehensive review of the issues surrounding disclosure in the digital era before rushing to switch the default for disclosure delivery to e-delivery. It should not, under any circumstances, adopt the approach proposed by industry of defaulting investors to e-delivery simply by virtue of their having provided the firm with a digital means of contact. Nor should it act abruptly to eliminate the requirement to digitally verify the selection of e-delivery without evidence that the change is warranted, that it will not lead to bad outcomes, and that appropriate alternatives are available to ensure that investors have genuinely chosen and are well equipped to use this form of delivery. The good news is that there is no urgent need to act. The flexible, principles-based policies adopted by the Commission in the mid-1990s have been remarkably successful in enabling firms to transition to e-delivery. The exciting challenge facing the Commission now is to develop an equally creative and flexible set of policies to deliver the full potential benefits of the digital era to investors and industry alike.

Respectfully submitted,

Barbara Roper
Director of Investor Protection

cc: Chairman Jay Clayton
Commissioner Hester M. Peirce
Commissioner Elad L. Roisman
Commissioner Allison Herren Lee
Commissioner Caroline A. Crenshaw