Proskauer

SEC Answers Questions on New Tailored Shareholder Report Requirements

February 23, 2024

The staff of the Division of Investment Management (the "Staff") has issued a FAQ pertaining to the rule and form amendments adopted by the Securities and Exchange Commission (the "SEC") in October 2022, which require open-end mutual funds and exchange-traded funds ("ETFs", and together with open-end mutual funds, "funds") registered on Form N-1A to transmit concise and visually engaging annual and semi-annual shareholder reports, and amend the advertising rules for all regulated investment companies, including closed-end funds and business development companies, to ensure fee comparability in fund advertising.[1]

Overview of Amendments to Shareholder Report Requirements

Purpose of Amendments. The amendments require shareholder reports to highlight key information deemed crucial by the SEC for retail investors to assess and monitor their fund investments. Shareholder reports must be made available online and filed on Form N-CSR semi-annually using Inline XBRL tags.

Content of Reports. The reports may only include information permitted or required by new Item 27A of Form N-1A, such as:

- fund/class name,
- ticker symbol,
- principal U.S. markets (for ETFs only),
- an expense table,
- concise disclosure of management's discussion of fund performance,
- a comparison of fund performance to relevant indices,
- performance graphs and tables,
- net assets,

- portfolio holdings, and
- material changes impacting various aspects of the fund.

Requirements. Incorporation by reference is not permitted for required information, and all data must be tagged using Inline XBRL. Further, if the report references online information, it must include a hyperlink for immediate access. One of the more potentially burdensome requirements is that each fund much produce individual shareholder reports, separate from other series of the same registrant, and a separate report for each class of a multi-class fund, ensuring shareholders only receive reports relevant to their specific class and/or series.

Exclusion from Rule 30e-3. Importantly, funds subject to these shareholder report requirements may not take advantage of Rule 30e-3, the rule that currently permits funds to use a "notice and access" approach to transmitting shareholder reports. Shareholders must directly receive tailored shareholder reports either in paper form or electronically (if a shareholder affirmatively elects).

The Staff's FAQ

The Staff published an FAQ specifically addressing questions about the tailored shareholder report amendments, and the following provides an overview of the key points addressed in it, organized into five broad categories.

1. **Appropriate Broad-Based Securities Market Index**. When comparing fund performance, funds must select an "appropriate broad-based securities market index" that accurately reflects the market in which a fund invests. The appropriate broad-based index must represent the overall applicable domestic or international equity or debt markets relative to a fund's investments, providing investors with insights into the fund's performance relative to the applicable broader market.

Examples. The following examples could qualify as broad-based indexes: (i) those covering the equity or fixed income market of groups of countries (e.g., Europe and Asia), groups of countries excluding a specific country (e.g., Asia excluding Japan), or groups of countries with shared characteristics (e.g., emerging markets); and (ii) for funds investing primarily in non-U.S. equity, those representing the overall equity market of the representative non-U.S. country. These examples could qualify as an appropriate broad-based index provided that the index represents the overall applicable market *relative to the fund's investments* (*emphasis added).* In addition, the Staff notes that given the tax-exempt status of municipal bonds, an index representing the national municipal securities market is considered a standalone overall market opposed to a subset of the fixed income market (and, by extension, such an index would qualify as a broad-based index).

The following indexes do not qualify as they, according to the Staff, do not represent the overall market in which a fund invests: (i) indexes focused solely on a specific industry sector (e.g., an index consisting only of healthcare companies) or (ii) indexes characterized by specific attributes like "growth", "value", "ESG", or "small- or mid-cap".

2. **Form N-CSR and Website Availability Requirements**

Combined Items for Form N-CSR. Funds may prepare combined financial statements for multiple series or portfolios in a trust to satisfy Item 7 of Form N-CSR, as long as it aligns with Regulation S-X.

The Staff notes that funds have the option to satisfy website availability requirements by posting the most recent Form N-CSR report in its entirety on the website specified in the report. This option permits Form N-CSR information to be grouped by type of materials and/or by series as long as certain presentation requirements are met, including that the grouped information: (i) is presented in a format that effectively communicates the information, (ii) clearly distinguishes between different types of materials and/or series, and (iii) provides easy navigation for shareholders, like through a table of contents with hyperlinks. Relying on this framework, the Staff believes that a combined response to multiple Form N-CSR items would generally be appropriate if the combined Form N-CSR response adheres to the three requirements identified above.

Compliance with Regulation D. Posting Form N-CSR information online under amended Rule 30e-1 does not violate the prohibition on general solicitation and advertising in Regulation D as long as the fund posts only the information required by Rule 30e-1 and does not use its website to offer or sell its securities in violation of Regulation D.

3. **Binding Individual Shareholder Reports of Multiple Funds.** Funds are permitted to bind, staple or stitch together multiple individual shareholder reports for investors who have invested in multiple funds or share classes. The Staff's concern about multi-series/class reports does not apply to this approach as the investor is still only receiving reports specific to the investments it holds. The Staff recommends that a fund consider including a table of contents when combining shareholder reports in this manner.

4. **Electronically Provided Shareholder Reports**

Hyperlinking Requirements. Shareholder reports delivered electronically must comply with hyperlinking requirements outlined in Instruction 9 to Item 27A(a) of Form N-1A. The Staff notes that if a hyperlink becomes stale or inaccurate, Rule 30e-1 provides a safe harbor for temporary noncompliance, provided the fund has reasonable procedures in place and takes prompt action to correct any issues.

Electronic Delivery Approaches. In addition to sending an email that includes the full shareholder report, funds can email, or otherwise electronically notify investors, with direct links to specific shareholder reports or direct investors to a website landing page with links to the shareholder reports for specific fund(s) and/or share classes(es) owned by the investor. Any other methods that adhere to the requirements of Instruction 4 to Item 27A(a) of Form N-1A for delivering fund and share class specific shareholder reports directly to investors in an electronic format are permissible.

5. **Compliance Date and Inline XBRL Issues**

Transmittal Timing and Form N-CSR Filing. Shareholder reports for funds registered on Form N-1A must adhere to the new amendments if transmitted to shareholders on or after the compliance date of July 24, 2024. Regardless of when filed, Form N-CSR should include the report actually transmitted to shareholders.

Tagging Requirements and Compliance Date. Tailored shareholder reports included in Form N-CSR transmitted to shareholders on or after July 24, 2024, must be tagged using Inline XBRL.

Amended Form N-CSR and Tagging. In cases where an issuer submits an amended Form N-CSR (N-CSR/A), and the originally filed N-CSR contained multiple tailored shareholder reports but only one is being amended, the Form N-CSR/A filing need only contain a complete version of the report being amended with all elements of that report tagged in Inline XBRL (not only the amended elements).

Variable Annuity or Variable Life Insurance Company Products

The FAQs also offer guidance specific to variable annuity and variable life insurance issuers (collectively, "variable contract issuers"), which is outlined below.

Online Hosting of Fund Materials. Materials required to be posted to a specified website pursuant to Rule 30e-1 may appear on either the variable contract issuer's website or the fund's website for funds offered as an investment option in variable contracts. If multiple variable contract issuers offer the same underlying fund, the Staff notes that it may be most efficient for that fund's required materials to be hosted on its website.

Binding Individual Shareholder Reports of Multiple Underlying Funds. Funds can bind, staple or stitch together multiple individual shareholder reports for variable contract investors who have allocated value to multiple underlying funds. The Staff's concern about multi-series/class reports does not apply to this approach as the variable contract investor is still only receiving reports specific to the funds to which it has allocated contract value. The Staff recommends that a fund consider including a table of contents when combining shareholder reports in this manner.

Optional Online Tools in Electronically Provided Shareholder Reports. Variable contract issuers only need to transmit reports containing information required under Rule 30e-2 and Rule 30e-1. They do not need to include any optional content an underlying fund may elect to include under Item 27A(a) of Form N-1A. If necessary, variable contract issuers may avail themselves of the safe harbor under Rule 30e-1 for temporary noncompliance with the hyperlinking requirements..

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[1] Tailored Shareholder Reports for Mutual Funds and Exchange Traded Funds; Fee Information in Investment Company Advertisements, SEC Rel. No. IC-34731 (Oct. 26, 2022).