

December 6, 2023

Countdown to Compliance with Tailored Shareholder Report Requirements: Key Considerations

In October 2022, the Securities and Exchange Commission (SEC) adopted amendments that will significantly alter the content, format and presentation of annual and semi-annual shareholder reports used by investment companies, including mutual funds and exchange-traded funds (collectively, funds) registered on Form N-1A (Amendments).¹ As discussed in a previous [S&K Client Alert](#), the Amendments will result in a new “tailored shareholder report” (TSR), a concise and visually engaging report that is better designed to meet the informational needs of retail investors. The TSR will be much shorter than current shareholder reports; each share class of each fund will have a separate TSR; and some information in current shareholder reports will not be permitted in the TSR and, instead, will be moved to Form N-CSR and made available on a website.

Complying with the Amendments is not merely an exercise in populating a generic template TSR. Rather, given the scope and nature of the Amendments (covering the TSR, N-CSR and website availability), funds should devote sufficient time to obtain input from various personnel – including operations, IT/systems, investor relations, marketing, finance, compliance and legal – and potentially service providers such as fund administrators, technology firms, printers, intermediaries and outside counsel.

While the Amendments create compliance and operational challenges for funds, they also create opportunities for funds to holistically rethink and refresh their investor communications in order to improve shareholder engagement. With less than eight months until the July 24, 2024 compliance date,² funds should now be considering how they will meet this objective. We summarize some key considerations below.

¹ See Tailored Shareholder Reports for Mutual Funds and Exchange-Traded Funds; Fee Information in Investment Company Advertisements, Release No. IC-34731 (Oct. 26, 2022), available at <https://www.sec.gov/rules/final/2022/33-11125.pdf> (Release).

² The Amendments became effective on January 24, 2023, and the compliance date is July 24, 2024. Therefore, any shareholder report actually transmitted to shareholders on or after July 24, 2024 must satisfy the TSR requirements. Given the requirement to transmit shareholder reports within 60 days after period end, most funds will likely begin using the TSR format for shareholder reports covering periods ending after April 30, 2024, unless they accelerate their reporting process and transmit shareholder reports prior to July 24, 2024.

I. Approach to Investor Communications: *Rethinking and Refreshing*

Shareholder reports are regulatory documents that satisfy disclosure and reporting obligations, but they also serve as marketing documents, as they can be valuable tools for engaging and educating existing and prospective shareholders. In this regard, a fund's preparation for the TSR is an opportunity to rethink – and perhaps refresh – its investor communications.

A. *Investor Communications Generally*

Annual and semi-annual shareholder reports are generally viewed as critical investor communications, as they each contain important information that allows shareholders to assess and monitor their investments. Over time, shareholder reports have expanded to contain more information about a fund, its adviser and financial data, which can overwhelm the presentation of information that is considered most important for retail investors, such as expenses, performance and portfolio holdings. The Amendments are intended to address this issue by requiring a concise shareholder report that highlights comparative information.³

Aside from changing the content, format and presentation of shareholder reports, the Amendments seem likely to result in the following:

- The Amendments may lead funds to modify materials that accompany shareholder reports. Many funds transmit shareholder reports with other materials, such as a portfolio manager letter explaining reasons for a fund's performance and providing opinions about future outcomes of an investment strategy. Because the Amendments prohibit the inclusion of certain information traditionally included in shareholder reports (e.g., lengthy management commentary and performance beyond 10 years), funds may choose other ways to convey – and highlight – this information. For example, as discussed in Section II below, funds may opt to include such information in the same transmission as the TSR and may refer to such information to draw investors' attention to it. Some funds may simply rearrange information, i.e., they will take information that traditionally has been included in shareholder reports and place it in other materials that accompany the TSR and/or are available on the fund website.
- The Amendments may increase investors' focus on fund websites as the main source of fund information. With the shareholder report significantly reduced in length, investors seeking more in-depth information may gravitate toward the fund website, where the fund has flexibility to highlight other materials – such as management commentaries – that contain information that is not permitted in the TSR.

B. *Concise, Impactful Content: Using Design Features, Online Tools and Electronic Media*

The TSR is designed to be a short document. Although the TSR is not subject to a page limit, the SEC has estimated that it will be approximately 3-4 pages in length.⁴ The content, format and presentation of the TSR is governed by new Item 27A of Form N-1A. Item 27A sets forth specific requirements and limitations regarding content in the TSR, but provides significant flexibility regarding how the content is formatted and presented.

³ Release at 47 (“a concise shareholder report that highlights the most relevant information for shareholders and promotes comparability across funds”).

⁴ See Release at n.369 and accompanying text.

- **Design Techniques:** Item 27A encourages funds to use design techniques that promote effective communication.⁵ For example:
 - question-and-answer formats
 - charts, graphs and tables
 - bullet lists
 - other graphics and text features
- **Online Tools and Electronic Media:** The Amendments promote the use of interactive, user-friendly electronic design features in TSRs that are posted on a website or otherwise provided electronically. In particular, Item 27A encourages funds to use online tools and electronic media designed to enhance an investor's understanding of material in the TSR.⁶ For example:
 - video or audio messages (accessible via hyperlink, website address or QR code)
 - mouse-over windows
 - pop-up boxes
 - chat functionality
 - expense calculators

As the TSR is designed to facilitate comparisons between funds, a fund may want to use the above-mentioned flexibility in ways that most effectively convey information. In addition, given the space constraints imposed by Item 27A and investors' general preference for concise disclosure, funds should strive to produce succinct, impactful content and use design techniques, tools and features that enhance investors' ability to notice and understand key information.

C. **Appearance and Functionality on Mobile Devices**

As investors are increasingly viewing and interacting with online content using mobile devices rather than desktop computers, a fund should consider how its TSR and website will appear and function on mobile devices. This consideration may be especially relevant where a fund uses design features, online tools and electronic media, as described above.

Funds should seek to ensure that, when the TSR or website is viewed on a mobile device, all content (including disclosures) appears and functions properly and in compliance with applicable regulations. For example, if a TSR or website uses mouse-over windows or pop-up dialogue boxes to display content, these features might not appear or function properly on a mobile device, thereby preventing investors from seeing the content. Similarly, images, logos and other graphics may appear differently on mobile devices than they do on desktop computers. Specific ADA-compliant enhancements should also be considered.⁷

⁵ See Form N-1A, Item 27A(a), Instruction 8.

⁶ *Id.*

⁷ The SEC specifically noted that funds are required to comply with accessibility-related obligations imposed by the Americans with Disabilities Act of 1990 (ADA). See Release at n.360 and accompanying text. Commonly, firms enhance websites with technology solutions to aid low vision or hearing-impaired persons in using fund websites; for example, coding that permits electronic screen reading functions, synchronous captioning for any video or audio features, alt-text descriptions of images (audio and visual), coding that effectuates keyboard combination tools, and minimum visual contrast ratios.

II. Additional Information: *Information Not Included in the TSR*

The Amendments generally allow a fund to include in a TSR *only* the information that Item 27A specifically permits or requires.⁸ A fund is therefore prohibited from including additional information – such as president’s letters, portfolio manager letters or general market commentary and other similar information – *within* the TSR. This prohibition represents a significant change, as the current framework allows a fund to include such additional information within the shareholder report. However, there are two methods by which a fund can direct investors’ attention to information *outside* of the TSR:

- **Accompanying Materials.** The Amendments permit a TSR to be “accompanied by” other materials – i.e., a fund may provide other materials in the *same transmission* as the TSR – so long as the TSR is given “greater prominence” than any other materials included in the same transmission, except for certain specified disclosure materials.⁹
- **Referring to Other Information.** The Amendments permit a fund to refer to “other information” that is available on the fund’s website if it reasonably believes that shareholders would likely view the information as important. Such “other information” may include, for example, additional performance presentations and commentary about how the fund performed.¹⁰ This referral must appear near or at the end of the TSR, so that it does not interrupt the flow to the TSR’s mandatory items.
 - If the TSR is posted on a website or otherwise provided electronically, the fund is required to provide a means of facilitating access (e.g., a hyperlink or QR code) to “other information” that is referenced in the TSR if such information is available online.¹¹
 - If the TSR is delivered in paper format, the fund may facilitate access to “other information” that is available online by including a website address, QR code or other means.¹²

Funds that wish to draw investors’ attention to information that is not permitted in the TSR – such as management commentary or performance beyond 10 years – can include that information in the same transmission as the TSR and/or refer to such information near the end of the TSR and provide a means of facilitating access, as described above. Funds can also take this opportunity to rethink the language used in presenting long-term performance, and in doing so they should be mindful of applicable advertising requirements¹³ and anti-fraud standards.¹⁴

⁸ See Form N-1A, Item 27A(a), Instruction 3.

⁹ The excepted materials include summary prospectuses, statutory prospectuses, notices of the online availability of proxy materials and other shareholder reports. See Form N-1A, Item 27A(a), Instruction 12.

¹⁰ See Form N-1A, Item 27A(i); see also Release at n.331 and accompanying text.

¹¹ See Form N-1A, Item 27A(i), Instruction 1.

¹² See *id.*

¹³ See Rule 482 under the Securities Act of 1933 (“Securities Act”), Rule 34b-1 under the Investment Company Act of 1940, and FINRA Rule 2210.

¹⁴ See Rule 156 under the Securities Act.

III. Management's Discussion of Fund Performance (MDFP)

A. Narrative Disclosure – More Concise; Use Graphics, Bullets, Tables

The Amendments retain the narrative MDFP section as part of the shareholder report but make the section more concise. Currently, funds are required to “discuss the factors” that materially affected the fund’s performance; under the Amendments, funds must “*briefly summarize the key factors*” (emphasis added) that materially affected the fund’s performance.¹⁵ The Amendments also include the following instructions:

- Use graphics or text features (e.g., bullets or tables) to present key factors, as appropriate.
- Do not include “lengthy, generic, or overly broad discussions” of key factors.

Many funds that are accustomed to including a lengthy narrative MDFP will have to modify their approach to this section. A fund may determine, for example, that certain discussion points that have historically been included in the MDFP may no longer fit within the more concise MDFP – in which case, the fund could include such discussion points in commentary on its website or in other materials. A fund could also determine that some discussion points with common elements can be grouped together or recategorized. A fund could also revisit the relevance of these factors and revise their presentation to reflect their importance or significance in fund performance.

B. Performance Line Graph – 10-Year Limit

Currently, the performance line graph can cover periods longer than 10 years;¹⁶ however, the Amendments limit the line graph to 10 years. Although a fund is not permitted to show performance beyond 10 years within the TSR, it can still show this extended performance on its website. In this regard, a fund should consider how to encourage investors to visit its website, where the fund is not limited to 10 years.

The Amendments require a fund that provides updated performance information on its website to include in the TSR:

- a statement directing shareholders to where they can find such information;¹⁷ and
- a means of facilitating access to the updated performance information – e.g., a hyperlink to the relevant webpage if the TSR is provided electronically or a website address or QR code if the TSR is delivered in paper format.¹⁸

Many funds provide updated performance information (e.g., most recent quarter) on their websites and therefore are required to include in their TSRs the above-mentioned statement and means of facilitating access. These requirements will, in effect, encourage shareholders to visit the fund’s website to learn more about the fund’s performance.

¹⁵ See Form N-1A, Item 27A(d)(1).

¹⁶ See Form N-1A, Item 27(b)(7), Instruction 8 (“line graph may cover earlier fiscal years”).

¹⁷ See Form N-1A, Item 27A(d)(2), Instruction 15.

¹⁸ See Form N-1A, Item 27A(a), Instruction 9.

C. **Broad-Based Securities Market Index – New Definition**

Form N-1A currently requires the line graph to include the performance of an “appropriate broad-based securities market index.” The Amendments retain this requirement but revise the definition of “appropriate broad-based securities market index” by adding an instruction that defines a “broad-based” index as one “that represents the overall applicable domestic or international equity or debt markets, as appropriate.”¹⁹ Funds continue to be permitted to show a narrower index reflecting the market sectors in which the fund invests²⁰ but also have to show, at a minimum, a broad-based index as defined in the amended Form N-1A. The requirement to show a broad-based index only applies to the TSR and the prospectus. A fund is not required to show a broad-based index in performance presentations on its website or in other materials, such as letters and fact sheets.

The SEC declined to publish a list of indexes that qualify as “broad-based,” but did provide general guidance.²¹ Funds should review the new definition of broad-based index and the SEC’s guidance when determining whether an index satisfies the new definition. The index selection appears simple but may be complex for certain funds (e.g., multi-asset and alternative strategy funds) that do not invest in a single overall equity or debt market.

IV. **Form N-CSR and Website Availability**

The Amendments require funds to file on Form N-CSR certain information that is currently included in shareholder reports.²² The Amendments also require funds to make available on a website (i) certain information that is filed on Form N-CSR and (ii) first and third quarter portfolio holdings (collectively, Online Materials).²³ Online Materials are subject to requirements regarding “accessibility” and “presentation,” as described below.

A. **Accessibility**

The Amendments set forth specific website “accessibility” requirements²⁴, including:

- A fund must include, on the cover page or at the beginning of the TSR, a statement indicating that additional information can be found at a website address.
- The website address must be specific enough to lead shareholders directly to the Online Materials, rather than to the home page or a section of the website other than on which the Online Materials are posted.

¹⁹ See Form N-1A, Item 27A(d)(2), Instruction 6.

²⁰ See Form N-1A, Item 27A(d)(2), Instruction 7.

²¹ See Release at 77-78.

²² The information currently included in shareholder reports that will need to be filed on Form N-CSR includes the disclosures required by Items 7 through 11 of Form N-CSR, namely (i) financial statements, (ii) financial highlights, (iii) remuneration paid to directors, officers and others, (iv) changes in and disagreements with accountants, (v) matters submitted to shareholders for a vote, (vi) statement regarding the basis for the board’s approval of investment advisory contract, and (vii) complete portfolio holdings. See Rule 30e-1(b)(2)(i); see also Release at 130-131.

²³ See Rule 30e-1(b)(2)(i)-(ii).

²⁴ See Form N-1A, Item 27A(b), Instruction 2.

- The website may be a central site with prominent links to the Online Materials. The SEC has stated that “an investor must be able to navigate from the landing page to each of the [Online Materials] with a single click or tap.”²⁵ This approach is consistent with the website layout currently used by many funds, which typically have a landing page that contains a link to each material.

These accessibility requirements should be familiar to most funds, as they are similar to those applicable to Rule 30e-3 notices and summary prospectuses.

B. Presentation

The Online Materials may be either separately available for each series or grouped by the type of materials and/or by series. If the Online Materials are grouped by type of materials and/or by series, the grouped information must satisfy specific “presentation” requirements.²⁶ In particular, the grouped information must:

- (i) be presented in a format designed to communicate the information effectively;
- (ii) clearly distinguish the different types of materials and/or each series (as applicable); and
- (iii) provide a means of easily locating the relevant information (including, for example, a table of contents that includes hyperlinks to the specific materials and series).

These presentation requirements may create website design challenges. Funds should consider each element of the presentation requirements and the related SEC guidance when updating their websites to include the Online Materials.²⁷

There may be particular design challenges for a fund that files with the SEC a combined Form N-CSR that includes multiple series and then posts the Form N-CSR on its website to satisfy the website availability requirement.²⁸ In that case, Online Materials will be “grouped” and therefore must meet the presentation requirements. It seems likely that many funds will use a table of contents containing hyperlinks to the specific materials and series.²⁹ This approach may necessitate various changes to the fund website, and careful consideration should be given to the layout and function of the table of contents and the terminology used therein.³⁰

²⁵ Release at 148.

²⁶ See Rule 30e-1(b)(2)(vii).

²⁷ See Release at 149-151 (discussing the presentation requirements).

²⁸ See Rule 30e-1(b)(2)(i).

²⁹ See Rule 30e-1(b)(2)(vii)(C) (providing that the means of locating the information may include “a table of contents that includes hyperlinks to the specific materials and series”); see also Release at 150 (“[F]or a fund complex that includes several funds, each with multiple classes, the fund complex’s website could include a master table of contents that contains hyperlinks to the specific materials for each fund and each class.”).

³⁰ See Release at 150 (“A fund generally should consider the terms it uses in its website presentation to describe the required materials, for example in a table of contents, to best facilitate shareholder understanding.”)

Finally, a fund should consider whether any TSR-related website changes might render inaccurate any *other* website addresses included in the fund's communications. For example, the summary prospectus must include a website address that leads directly to certain materials,³¹ and funds typically include website addresses in their statutory prospectuses, shareholder letters and fact sheets to direct investors to specific information.

V. Separate Reports for Each Series, and Each Class of Each Series

Many fund registrants have multiple series and multiple classes of each series. Currently, registrants usually prepare a single shareholder report that covers multiple series and multiple classes. By contrast, the Amendments require a separate shareholder report for each series and each class, such that a shareholder will receive a TSR that covers only the specific series and class in which the shareholder is invested.³² The hyperlinks in the TSR should take the shareholder to a series-specific webpage, or to a webpage that hosts a table of contents including hyperlinks to the specific materials.³³

This new requirement adds complexity and changes the process for preparing shareholder reports. Many funds will rely to a large extent on their fund administrator and other service providers that have developed technological tools for preparing the series- and class-specific TSR. Although service providers are offering automated solutions, funds should expect to be heavily involved in many aspects of the process and therefore should begin coordinating with their service providers well in advance of the compliance date.

VI. Transmission of Shareholder Reports: *Mailing Paper Copies vs Electronic Delivery*

In 2021, funds began relying on Rule 30e-3, which generally permits a fund to satisfy shareholder report transmission requirements by mailing a paper notice of website availability ("notice and access") rather than mailing paper copies of the full shareholder reports.

The Amendments exclude open-end funds from the scope of Rule 30e-3, thereby prohibiting them from using "notice and access." Accordingly, beginning July 24, 2024, funds will be required to mail paper copies of the TSR to shareholders who have not consented to electronic delivery.

Funds seeking to reduce printing and mailing costs may therefore wish to obtain shareholders' consent to electronic delivery.³⁴ The process of obtaining consent can take some time, as it may entail coordinating with third parties such as the fund's transfer agent and other service providers as well as intermediaries. While many funds already obtain consent from *new* shareholders as part of an account-opening form, a different approach is needed to obtain consent from *existing* shareholders.

³¹ See Rule 498(b)(1)(v) under the Securities Act.

³² See Form N-1A, Item 27A(a), Instruction 4.

³³ See Rule 30e-1(b)(2)(vii); Form N-1A, Item 27A(a), Instruction 9; Form N-1A, Item 27A(b), Instruction 2.

³⁴ Instead of receiving paper copies of fund documents, shareholders who have consented to electronic delivery typically receive an email that contains a link or notice directing them to a website where the documents are available.

Funds should be mindful of the SEC guidance permitting electronic delivery.³⁵ The guidance permits funds to transmit shareholder reports electronically in lieu of paper if they satisfy conditions regarding notice, access and evidence of delivery.³⁶ Funds typically will obtain “informed consent”³⁷ to satisfy the evidence of delivery condition, and the consent is usually a “global consent,” which means it covers all documents, not just shareholder reports. All aspects of the consent documentation and operational arrangements for electronic delivery should be carefully structured to comply with the SEC guidance.

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Seward & Kissel LLP will continue to provide insight on any related developments. If you have any questions regarding the matters covered in this memo, please contact any member of our Registered Funds Group.

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³⁵ See Use of Electronic Media for Delivery Purposes, Release No. IC-21399 (Oct. 6, 1995); Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery of Information, Release No. IC-21945 (May 9, 1996); Use of Electronic Media, Release No. IC-24426 (Apr. 28, 2000).

³⁶ Specifically, the shareholder must receive notice that the document is available, the shareholder must be able to access the document, and the fund must have evidence of delivery. The SEC guidance addresses each of these conditions in detail.

³⁷ The SEC guidance describes various elements of “informed consent.”