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# Innovation in Fund Disclosure: The Potential, the Barrier, and the Path Forward

## Innovation in Fund Disclosure: The Potential, the Barrier, and the Path Forward

## General Counsel's Address, 2016 Mutual Funds and Investment Management Conference

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*As prepared for delivery.*

Good morning, everyone, and welcome. Thank you for joining us.

Really quick, I'd like you to think about something—when was the last time you used a pay phone? I remember the last time I did. I was in Chicago, on a business call. It must have been 2004 or 2005.

Now, of course, you'd be hard-pressed to find a pay phone. New York City is converting old phone booths into Wi-Fi hot spots, and our smartphones connect us to the world in seconds. Both are wonderful illustrations of a remarkable commitment to innovation.

I bring this up because you, too, are part of a remarkable commitment to innovation—the fund industry's.

What I'd like to talk about this morning involves building on that commitment, for the benefit of our shareholders. I'll cover it in three points:

- First, there's an area where our industry has great potential for innovation right now.
- Second, there's a barrier holding us back from pursuing it.
- And third, there's a way to set ourselves on a path toward it.

The first point is simple. There is tremendous room for creativity and innovation in how we provide and present our shareholders with information.

- We can enhance our communication with fund shareholders.
- We can improve the visual appeal of the information we provide, and make it more interactive.
- We can make that information more easily accessible, so that shareholders can quickly get what they need without having to wade through the stuff they don't.
- And we can do all of this while saving shareholders money.

The best part is, realizing these opportunities requires just one basic thing—delivering more information online.

Industries across the economy have embraced online delivery of information to great success:

- In banking, for example, we used to send out checks to pay the bills and wait for monthly statements to come in the mail, so we could balance our checkbooks. Millennials in the crowd, I promise you this is true. Now, we can look at balances every day. Just this morning, I checked my balance and paid a bill, all on my phone. Not a single piece of paper was involved.
- Or think about health care. We used to go to the doctor's office and fill out a form to get our medical records, which were stored in huge file cabinets. Now, we can make doctor's appointments and easily get our health records online.
- The music industry, too. Remember when you used to have to head down to the record store to buy an album? Now, you download or stream it and have it instantly. I watched the Steve Jobs movie recently—not the greatest movie, but the vision to enable people to listen to music on a phone was amazing.
- And what if that movie had come out a decade ago? I would have had to go to a video store to rent it on VHS—and then return it to the store, making sure I had rewound it. I ended up watching it on my tablet, thanks largely to his innovative vision.

That last one hits close to home. I worked at a Blockbuster store one summer—employee of the month three months in a row right here!—and, well, let's just say it's now a … Verizon Wireless store.

What I'm getting at is this: online delivery of information has, time and time again, proven itself to be the gateway to further innovation, with consumers reaping major benefits.

Just the few examples I mentioned have saved us time and money … made content we were looking for more accessible … and introduced us to new content tailored to our wants and needs. You have to believe that, for our shareholders, delivering information online can do the same.

The problem is, something's holding us back—this is the second point I'd like to make this morning. The default delivery mechanism for two of our industry's most essential disclosure materials—shareholder reports and summary prospectuses—is stuck in a bygone era, and its stifling the potential for innovation.

Under the rules in place today, funds must mail paper copies of those disclosure materials to any shareholder who does not take the time to opt in to electronic delivery. Even beyond the lost opportunities for innovation, this antiquated paper delivery default is costing us all big time.

Let's use the shareholder report example.

We can print about 128 of these reports with the paper produced by one tree. Now, that might not seem so bad, until you think about how many we send out each year.

Any guesses—how many shareholder reports do you think we, as an industry, send out each year?

Well, we added it up, and the answer is 240 million. We print 240 million shareholder reports a year—killing about 2 million trees a year in the process.

Count all the harmful compounds emitted during paper manufacturing—along with the massive amounts of waste that discarded paper produces—and we're absolutely crushing the environment here.

And don't forget about the monetary cost in addition to the environmental damage. It's ultimately fund shareholders who bear the $308 million a year it costs to print and deliver these lengthy documents.

Keep in mind also that these figures are for shareholder reports only. Imagine how high they'd grow if we counted all the disclosure materials that we still have to send to fund shareholders in hard copy.

The SEC has wisely recognized the benefits of delivering information online. Last year, it proposed to flip the delivery default for shareholder reports from paper to the web.

If adopted, the proposal would give funds the option to forgo mailing shareholders a full paper report—and instead mail them a notice with the website where the report is available online, along with a postage-paid reply form and toll-free number that they could use to opt back in to a hard copy.

The SEC is on the right track here, and I'll give you four reasons why:

- First, it would save shareholders a ton of money—I'm talking about hundreds of millions of dollars here. And if the SEC adopted ICI's recommendation that funds should only have to mail a postcard notice, shareholders would save hundreds of millions more.

- Second, the proposal would preserve shareholder choice in how they receive information—because those who want to keep receiving paper reports would still be able to get them.
- Third, it would meaningfully reduce our industry's environmental footprint. We'd help reduce waste … we'd save energy and raw materials … and we'd breathe cleaner air.
- And fourth—with apologies to Malcolm Gladwell—it could well be the tipping point for widespread creativity and ingenuity in this space.

So, adopting the SEC's proposal sounds like a no-brainer, right? Well, bizarrely, we're deep in a debate about its merits—and some groups are fighting hard against it.

One is the paper lobby. We're highly skeptical of this opposition, first and foremost, because these folks have a commercial interest in maintaining the outdated paper delivery model.

We're also skeptical because one of their main arguments against the proposal—that it would disadvantage people with less access to the Internet, such as older people—doesn't hold up to even casual scrutiny. They pass off Internet-use statistics for the general population as though it is representative of fund shareholders—and, wouldn't you know it, inaccurately portray fund shareholders' Internet access as lower than it actually is.

The truth is, fund shareholders are a tech-savvy lot. They have greater access to the Internet—spread across ages, incomes, and levels of education—and make more use of it for financial purposes than the general population does. This is especially true for people age 65 or older.

Some critics with ties to the paper industry are cloaking themselves in the interests of older shareholders to support their weak argument. Several of these folks have even posed as concerned senior citizens without bothering to disclose those ties!

They'd have you believe that America's older fund shareholders just love reading their paper shareholder reports. Yet somehow, after being prompted by a conspicuous paper notice sent directly to them, they would lack the wherewithal to pick up the phone to request a hard copy if they wanted it.

This stubborn defense of paper brings to mind a great line from "The Office." You might remember it—and I hope you will after today. In an ad for paper company Dunder Mifflin, legendary boss Michael Scott makes the pitch—

"Limitless paper in a paperless world."

I love it—it explains exactly what the proponents of the paper delivery default are pushing for. Preserving some need for paper, here subsidized by fund shareholders.

We've got more to worry about than Big Paper, though. The proposal also is facing stiff opposition from a powerful firm—the top vendor delivering fund shareholder reports on behalf of brokers.

This is pretty complex, so let me explain.

The vendor has based its opposition in part on an interpretation of a New York Stock Exchange rule that allows brokers to charge "processing fees" to funds for delivering the funds' shareholder reports. Most brokers that distribute fund shares contract with this vendor to take care of the delivery.

Under the vendor's interpretation of how the NYSE rule would apply to shareholder report delivery under the SEC's proposal, the processing fees it charges to funds that opt for the online delivery default would more than quadruple.

All told, due to this interpretation, shareholders would stand to lose out on more than a billion dollars in potential savings over the next decade alone.

How crazy is this? Let me put it in black and white.

Under this interpretation, it would cost funds more not to deliver paper shareholder reports than they currently pay to deliver them.

That is a surreal outcome.

But it highlights an important point—this New York Stock Exchange rule is sorely in need of a rethink:

- At best, it is ambiguous.

The processing fees are subject to a schedule designed for the distribution of operating-company proxy materials. How the fees would apply to online delivery of fund shareholder reports is far too open to interpretation.

- At worst, it promotes abusive practices.

The schedule sets maximum fees that a broker can charge a fund for delivering a shareholder report—but, in practice, the maximums act as an obligatory standard. And if the broker can negotiate with the vendor to deliver a shareholder report at a cost that is lower than what the broker charged the fund—the broker pockets the difference, in what effectively is a kick-back.

So there are a few hurdles ahead, to be sure. But here's the good news—we know what it will take to clear them, and to set ourselves on a path toward greater innovation in fund disclosure. That's the third point I'd like to make this morning.

The opportunities for greater innovation in fund disclosure are there for the taking—we just have to go get them. For that to have any chance of happening, the SEC must first adopt its proposal to flip the default delivery model for shareholder reports from paper to the web—ideally with ICI's recommendation for even greater savings.

As for the New York Stock Exchange fees, the Commission needs to explain, in the proposal's adopting release, how they apply to the online delivery of fund shareholder reports. And, in keeping with the SEC's investor protection mandate, that explanation must focus on maximizing cost savings for fund shareholders.

I can't think of any reason why the New York Stock Exchange is governing funds' delivery fees—it doesn't make any sense. Maybe it did back in the 1960s, but not today.

There's a better way to do this—and a better group to do it.

As the primary self-regulatory organization responsible for overseeing broker-dealers—with protecting investors as an integral part of its mandate—FINRA is the right group to take on this challenge. Indeed, it is the only body equipped to do so. A tailored fee schedule designed by FINRA would untangle our industry from the current proxy-distribution paradigm designed for operating companies, and allow fund shareholders to pay the fair fees they deserve.

Today, we submitted letters to the SEC, the New York Stock Exchange, and FINRA, calling for them to move on what I've just laid out.

If you think about it, what I'm calling for here isn't particularly extraordinary. Innovation has always been one of our industry's core strengths, from the versatile fund products we've developed over the years, to the sound, forward-thinking investment strategies we've designed, and everything in between. I'm just calling for us to expand on it.

The SEC's proposal is a great first step toward that end, and I thank Dave Grim and his team for advancing it. The Commission now can't afford to pass up the chance to adopt it and get the ball rolling. Nor can we in the industry afford not to hold up our end of the bargain—we must take every opportunity for innovation that an online delivery default will offer, for the long-term good of our shareholders. The time for action is now—and we are steadfast in our determination to see it through.

Thank you for your time and attention.

Before we get going with the conference, I'd like to acknowledge our sponsors, which you can see on the screen behind me, as well as the ICI staff and our speakers and panelists.

We've got a fantastic three days ahead of us—the agenda is just jam-packed—and we couldn't have put it all together without any of them. Please join me in thanking the sponsors, staff members, and speakers and panelists.

We've got an exciting, content-rich conference ahead of us, and I know you'll enjoy it as much as you'll learn from it. I'll spare you a read of the agenda, but there's one important event I'd like to highlight—tomorrow's Women in Leadership forum.

This forum is the product of years of grassroots efforts aimed at supporting diversity in the industry, including women in leadership positions. Events like this one help foster a culture of diversity and inclusion throughout the industry and promote a variety of perspectives and communication styles at every level of management. It's a member-driven initiative, and we are very proud to be able to make it happen.

We've been thrilled with the response—we had to set up a waiting list to get in. I hope you signed up and will participate in the dialogue.

Now, I'm very pleased to introduce today's keynote speaker, David Grim. As you all know, Dave heads the SEC's Division of

Investment Management. He has worked in IM, and risen up the ranks, for more than two decades—his entire career.

Dave is responsible for administering the SEC's regulatory functions for more than 10,000 mutual funds and ETFs and about 12,000 investment advisers, with more than $62 trillion in assets under management. No small undertaking.

Over the years, Dave has seemingly been involved in every issue of importance to the fund industry—for example, he helped write the SEC's amicus brief in *Jones v. Harris*.

From our days together at the SEC, I know first-hand his exceptional talent, and his steadfast commitment to the SEC's mission.

Please join me in welcoming Dave Grim, director of the SEC's Division of Investment Management!

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