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November 2, 2016

Mr. Brent J. Fields  
Secretary  
US Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549

Re: *Disclosure Update and Simplification* (File No. S7-15-16)

Dear Mr. Fields:

The Investment Company Institute<sup>1</sup> appreciates the opportunity to comment on the Securities and Exchange Commission's proposed disclosure update.<sup>2</sup> The proposed amendments address certain disclosure requirements that may have become redundant, duplicative, overlapping, outdated, or superseded, in light of other Commission disclosure requirements, US Generally Accepted Accounting Principles ("GAAP") or changes in the information environment. The Proposing Release indicates that the amendments are intended to facilitate the disclosure of information to investors, while simplifying compliance efforts, without significantly altering the total mix of information provided to investors. The amendments are part of an initiative by the Division of Corporation Finance to review disclosure requirements applicable to issuers to consider ways to improve the requirements for the benefit of investors and issuers.

Certain of the proposed amendments address registered investment company disclosure requirements. Specifically, the proposed amendments modify certain financial statement disclosures to conform them to GAAP, and define "extraordinary expenses" for purposes of the prospectus fee table expense presentation. We strongly support these proposed amendments. In addition, we recommend that the Commission conform the presentation of distributions paid in the statement of changes in net assets to GAAP, as more fully described below.

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<sup>1</sup> The Investment Company Institute (ICI) is a leading global association of regulated funds, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's US fund members manage total assets of \$18.5 trillion and serve more than 90 million US shareholders.

<sup>2</sup> *Disclosure Update and Simplification*, Release Nos. 33-10110, IC-32175, 81 Fed. Reg. 51607 (August 4, 2016) ("Proposing Release"), available at <https://www.sec.gov/rules/proposed/2016/33-10110.pdf>.

### *Financial Statement Disclosures*

Regulation S-X currently requires registered investment companies to separately present three components of distributable earnings on the balance sheet: 1) accumulated undistributed net investment income; 2) accumulated undistributed net realized gains (losses) on investment transactions; and 3) net unrealized appreciation (depreciation) in the value of investments.<sup>3</sup> Regulation S-X requires these amounts to be presented on a book basis. GAAP for investment companies requires that these three components be aggregated and presented as a single line item: distributable earnings.<sup>4</sup> GAAP also requires the components of distributable earnings to be disclosed on a tax basis in a note to the financial statements, so that investors can determine the amount of accumulated undistributed earnings they could potentially receive in the future as taxable distributions.

The Proposing Release notes that registered investment companies are typically structured so that they are not subject to fund-level tax on amounts distributed to investors. As such, the book basis components of capital required by Regulation S-X do not provide investors with insight into the tax implications of fund distributions. The proposal would amend Rule 6-04.17 to omit the requirement to separately disclose the three components of distributable earnings, and instead require disclosure of the total distributable earnings on the balance sheet. The proposal also would delete the requirement in Rule 6-09.7 for parenthetical disclosure of undistributed net investment income, on a book basis, in the statement of changes in net assets.

We support the proposed changes to the balance sheet and the statement of changes in net assets. We believe the GAAP required disclosure of tax basis distributable earnings better informs investors about the amount of accumulated undistributed earnings they could potentially receive in the future as taxable distributions.<sup>5</sup>

### *Distributions Paid*

We recommend that the Commission make a similar change to the Regulation S-X required disclosure of distributions paid in the statement of changes in net assets. Specifically, Rule 6-09.3 requires the fund to separately disclose distributions paid to shareholders from net investment income and realized gains. GAAP, however, requires distributions paid to be disclosed as a single line item, *distributions to shareholders*.<sup>6</sup> GAAP also requires any distribution that represents tax return of capital to be disclosed separately as a second line item in the statement of changes in net assets. In addition,

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<sup>3</sup> See Rule 6-04.17 of Regulation S-X.

<sup>4</sup> See ASC 946-20-50-11.

<sup>5</sup> We also support the proposed change to Rule 6-07 of Regulation S-X enabling investment companies to present a statement of comprehensive income, if applicable.

<sup>6</sup> See ASC 946-205-45-3.

funds must disclose the tax basis components of dividends paid (ordinary income, long term capital gain, and return of capital) in the notes to the financial statements.<sup>7</sup>

We recommend that the Commission conform the presentation of distributions paid in the statement of changes in net assets to GAAP. Our recommended change is consistent with the Commission's proposed changes to the balance sheet and the statement of changes in net assets because it would conform the S-X required presentation to GAAP and focus fund investors on the tax basis of distributable earnings and distributions paid. Our recommended change also would satisfy the stated objectives of the rule-making because it would facilitate the disclosure of information to investors, while simplifying compliance efforts, without significantly altering the total mix of information provided to investors.

The financial highlights information required by Item 13 of Form N-1A requires distributions from net investment income and realized gains to be reported separately. While GAAP permits distributions to shareholders to be presented as a single line item in the financial highlights,<sup>8</sup> we believe separate presentation of per share amounts is informative to shareholders. Therefore, we recommend no change to the presentation of distributions paid in the financial highlights.

#### *Registration Statement Disclosures*

Form N-1A enables funds to exclude "extraordinary expenses" as determined under GAAP from annual fund operating expenses when preparing the prospectus fee table.<sup>9</sup> The Proposing Release notes that the FASB recently eliminated the concept of extraordinary expenses from GAAP. The proposal would define extraordinary expenses<sup>10</sup> in Item 3 of Form N-1A so that funds could continue to exclude such expenses from their expense ratio in the fee table, providing investors with a better understanding of the ongoing level of expense associated with an investment in the fund. The Form would continue to require footnote disclosure of expenses including extraordinary expenses, if material. The proposal makes the same amendment to Form N-3, Form N-4, and Form N-6. We support the proposed definition of extraordinary expenses and its incorporation into the instructions to the prospectus fee table.

We appreciate the opportunity to comment on the proposal. If you have any questions on our comments or would like additional information, please contact me at 202/326-5851.

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<sup>7</sup> See ASC 946-20-50-8.

<sup>8</sup> Any distributions representing tax return of capital must be presented separately. See ASC 946-205-50-7.

<sup>9</sup> See Instruction 3(c)(ii) to Item 3 of Form N-1A.

<sup>10</sup> Extraordinary expenses refers to expenses that are distinguished by their unusual nature and by the infrequency of occurrence. Unusual in nature means the expense has a high degree of abnormality and is clearly unrelated to, or only incidentally related to, the ordinary and typical activities of the fund, taking into account the environment in which the fund operates. The environment of a fund includes such factors as the characteristics of the industry or industries in which it operates, the geographical location of its operations, and the nature and extent of governmental regulation.

Sincerely,

A handwritten signature in black ink that reads "Gregory M. Smith". The signature is written in a cursive, slightly slanted style.

Gregory M. Smith  
Senior Director – Fund Accounting

cc: Matt Giordano, Chief Accountant  
Division of Investment Management  
US Securities and Exchange Commission