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Submitted Electronically

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Ms. Vanessa Countryman, Secretary
U.S. Securities and Exchange Commission
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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

Ladies and Gentlemen:

Morningstar welcomes the opportunity to comment on the Securities and Exchange Commission's (Commission or SEC) Proposed Rule on 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 (Proposed Rule).[1] Morningstar's mission is to empower investor success. Because we offer an extensive line of products for individual investors, professional financial advisors, and institutional clients, we have a broad view on the Proposed Rule and its possible effect on the investment disclosures that investors will receive. Specifically, relevant to the Proposed Rule and its impact on the disclosure framework for mutual funds and exchange-traded funds (ETFs), we collect data from the Form N-CSR and Form N-1A to provide our clients with guidance on how they can understand the status of their investments.

This letter contains: 1) a summary of our views and 2) detailed answers to selected questions posed in the preamble to the Proposed Rule.

Executive Summary

Morningstar has a number of recommendations regarding the Proposed Rule. For the annual report, we recommend:

[1] SEC. 2020. 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. https://www.federalregister.gov/documents/2020/11/05/2020-17449/tailored-shareholder-reports-treatment-of-annual-prospectus-updates-for-existing-investors-and (Proposed Rule).

- Establishing a uniform format for the annual shareholder report so investors can more easily compare funds
- Providing shareholders with a table of contents organized by topic for one website hosted by the fund company where all documents will be available
- For performance reporting, disclosing one-, five-, and 10-year returns in the simplified example to provide sufficient meaningful information for investors
- Permitting the primary benchmark to be suitable for the investment strategy of the fund and not limited to the proposed broad-based index
- Indicating the reasons for a fund's outperformance and underperformance of benchmarks to enable investors to better evaluate a fund in their portfolios
- Including the deviation of net asset value (NAV) from market value over 10 years or during the life of an ETF, if shorter than 10 years
- Requiring funds that invest in private securities to explain their valuations of private securities relative to other reasonable alternative valuations on a historical basis to provide a more accurate valuation of the fund
- Requiring funds to decompose returns into trough-to-peak and peak-to-trough to highlight downside risk to investors
- Requiring funds to illustrate allocation by asset class
- Including statistics on how much the fund manager invests in the fund into the annual report to signal the extent to which the manager's interests are aligned with fund investors'
- Including language explaining to investors that they are owners in the fund and that portfolio managers work for them via an independent operating board and providing sufficient contact information for investors to reach the board
- Adjusting the expense ratio to exclude interest expenses and dividends collected by funds on short sales to give investors a better sense of what a fund company is charging them for the cost of running the fund and to enable investors to more easily compare expenses among several funds
- Maintaining the current expense ratio practice of including acquired fund fees and expenses (AFFE) and other specifics for Fund of Funds (FoFs)
- Improving notices to investors of material fund changes in order to explain the effects of each change and direct investors to the updated parts of the prospectus and statement of additional information (SAI)

With respect to other aspects of the Proposed Rule, we recommend the following:

- Regarding the Form N-CSR:
    - Requiring the N-CSR to be both human-readable and in a structured data format (inline XBRL) with tags for each form item and data elements within the financial highlights and consolidated financials
- Regarding the presentation of the fee table:
    - Presenting interest and dividends as separate line items in the fee table

    - Presenting the AFFE estimate as a separate line item in the fee table and including it in the expense ratio
- Regarding advertising literature:
    - Requiring funds using third-party ratings in advertising to display the most recent ratings information and to specify whether the ratings information is based on the fund itself, the portfolio management team, or the fund company.
    - Requiring new funds seeking to use information from a related fund to implicate performance to specify how the new fund differs from the comparative fund whose performance is being displayed
- Regarding Form 497 in EDGAR:
    - Making no changes to the filing

I. Annual Report and Semiannual Report

a. We support a concise annual report that is well-organized and in a structured format.

We support a concise, streamlined disclosure to shareholders. We believe that a three- to four-page annual report and shorter semiannual report containing the essential information about a fund's performance, material changes, principal risks, and other basic information is appropriate for shareholders. We think that more detailed information about the fund should be found on one website hosted by the fund company and investors should be provided with clear directions on how to access such information.

We recommend that the Commission establish a uniform format for the annual shareholder report, as it has when displaying information on more structured filings like Form N-MFP, to enable investors to more easily compare funds. The disclosure of data in Forms N-1A and N-CSR vary both across and within fund complexes, diminishing comparability for the average investor. For example, the scope of the administrative fees reported in the N-CSR differs across registrants with inconsistent disclosure of fee components, with some firms providing more detailed breakdowns, such as by reporting sub-transfer agency fees while others do not. Varying definitions for the same fee and variation in what fees are reported reduce the comparability of these filings for investors. Given that the annual report will be short and will be the only document directly sent to shareholders (unless they request additional documents), such a report should be standardized so that investors can easily compare funds and review such documents in a reasonable amount of time.

Furthermore, every element of the annual report should be tagged in a structured format so that third parties and regulators can analyze the information and provide investors with useful comparative information.

As it stands right now, the commission is proposing to expand inline XBRL to the N-CSR. We agree with Commissioner Allison Herren Lee on the value of structured data in general. In her speech to the U.S. Investor Forum earlier this year, she noted that, "the introduction of structured data requirements for financial statement and prospectus information has had significant benefits for investors, analysts, and other market participants, making it easier and less costly to extract, filter, compare, and otherwise analyze the information in SEC filings."[2] With respect to the shareholder reports in particular performance information, the benchmark being utilized, the material changes, and each principal risk (including its description, the rank of the risk, and any other significant information) should all be separately tagged items in a structured format so that every component of the annual report can be analyzed and compared across and within fund complexes.

To further enhance the value of the streamlined report, we also recommend that the commission require funds to provide the shareholder with a table of contents to one website where all documents will be available. This recommendation is offered in response to the Commission's question number 16: "Is there additional information that we should permit or require funds to provide on the cover page or at the beginning of their annual reports? If so, what are the benefits of that additional information? For example, should we permit or require funds to include a table of contents, or would a table of contents add undue length to the shareholder report and provide limited benefits to shareholders given the general brevity of the report?"[3]

Currently, determining whether to look in the prospectus, SAI, or another document altogether for specific detailed information is impossible to determine without going to each source. The location of information is not standardized, and no document tables of contents are typically provided by fund complexes. A guide to specific data points would be even more relevant for investors. Since the naming and scope of data points could vary by fund, we recommend that the guide, at a minimum, contain all data points reported in inline XBRL using the SEC-provided tag as the data point name with the filing and page on which the data is located.

b. We recommend tagging data on principal risks.

Given the brevity of the entire report, we agree with the Commission that principal risks should be distinguished by whether the risk would place more than 10% of the fund's assets at risk and whether it is reasonably likely that a risk will meet this 10% standard in the future.[4] Currently, mutual funds disclose a number of risks that are not relevant to most investors. They disclose these risks simply to mitigate legal risk. We recommend that the Commission create a taxonomy of principal risks or ask the industry to do so in order to have a consistent categorization of each principal risk. The

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[2] SEC. 2020. "The Promise of Structured Data: True Modernization of Disclosure Effectiveness." https://www.sec.gov/news/speech/lee-structured-data-2020-11-17.
[3] Proposed Rule, P. 70734, Q.16
[4] Proposed Rule, P. 70798

rank, category, and description of each risk should be tagged to allow for comparative analysis across funds. Such tagging would assist the Commission in identifying emerging risks in the fund industry and empower third parties serving investors to inform investors about comparative risks across funds.

c. We recommend more detail around performance reporting.

Regarding the reporting of performance in the annual report, we have several specific suggestions for funds. The Commission asks whether "restricting the example to including expense information for one- and 10-year periods accomplish[es] the goal of streamlining the fee summary, while providing meaningful disclosure" and whether "the simplified example [should] include different time periods, and if so, which ones."[5]

In response to the Commission's query, we think that one-, three-, five-, and 10-year returns, when available, are appropriate. As almost half of active share classes have a track record of less than 10 years, not all reports would feature this information, reducing the volume of information received by shareholders. The five-year return is important in providing investors a longer time-horizon than just the one- and three-year returns, particularly in cases where the 10-year period has not been reached. We believe that the Commission's proposed time periods of one-year and 10-year performance, one-year and three-year performance for a new fund, or life of a fund, if shorter, are insufficient for investors.[6] The proposal provides a very short and very long time horizon. Many investors, on the other hand, will be better served by an intermediate time horizon, such as three or five years. Thus, we recommend showing one-, three-, five-, and 10-year returns when available or the life of the fund if any of these periods are unavailable.

Second, we appreciate the Commission's intention to have investors measure their fund's performance against a broad-based benchmark index that "affords a greater basis for comparability than a narrow index would afford,"[7] but we believe that the commission needs to allow additional benchmarks for multi-asset funds. We note further that broad-based indexes as benchmarks need to be suitable for the investment strategy of the fund being benchmarked. For all funds, the appropriate benchmark needs to be matched to the investment strategy of the fund (for example, a value fund should not be benchmarked to the S&P 500 but rather to an index of value stocks). For multi-asset funds, we do not believe a single asset index (for example, a broad-based equity index) is appropriate. While the Commission allows for blended indexes to be the secondary benchmark,[8] many investors will focus on the primary benchmark. Restricting the indexes that these funds can use as their primary benchmark would result in their funds' performance being compared with a noncomparable index.

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[5] Proposed Rule, P. 70792, Q. 232.
[6] Proposed Rule, P. 70791.
[7] Proposed Rule, P. 70741, F. 198.
[8] Proposed Rule, P. 70742, Q. 50.

Consequently, multi-asset indexes should be allowed as the primary benchmark and the primary benchmark should be selected to align with the investment strategy of the fund.

Third, we believe that discussion of performance and the causes of deviation from the primary benchmark should be specific and informative. We recommend that funds be required to show performance against the primary benchmark for down markets, as defined by a 15% loss, and subsequent up markets until the next down market of 15% or more, for the past five years, as shown in the example in Exhibit 1. A good qualitative analysis explains the reasons for outperformance and under performance of benchmarks.

The example in Exhibit 1 shows the value of such an approach. It covers a trailing five-year period using a loss threshold of at least 15% with decomposed results shown in up and down markets. Displaying results in this manner would help investors understand how a fund produced its record versus the benchmark over the period covered. The examples compare American Funds American Mutual and Madison Dividend Income to the S&P 500. It is easy for investors to see from the charts that these funds have underperformed the S&P 500— the primary prospectus benchmark for both funds— because of underperformance in up markets. Both funds have proved more resilient than the benchmark in every down market. An investor who held one of these funds as an intentionally conservative investment option might find these results reassuring.

Alternatively, investors who had a fund in their portfolios because they thought it was defensive but then later noticed it consistently underperformed in up markets might think twice about continuing to hold it even if it were more competitive with or ahead of the benchmark.

Exhibit 1

5-Year Performance Annualized and Cumulative in Up and Down Markets (15% Loss Threshold)							
			Up	**Down**	**Up**	**Down**	**Up**
	Start Date	10/1/15	10/1/15	9/21/18	12/25/18	2/20/20	3/24/20
	End Date	9/30/20	9/20/18	12/24/18	2/19/20	3/23/20	9/30/20
Name	**Ticker**	**Annlzd Ret (%)**	**Cumulative Return (%)**				
American Funds American Mutual A	AMRMX	10.32	51.53	-12.98	30.91	-29.76	34.80
Madison Dividend Income Y	BHBFX	11.81	57.24	-12.19	33.69	-31.91	39.05
S&P 500 TR USD		14.14	62.31	-19.36	47.38	-33.79	51.75

Fourth, for ETFs, performance information should include the deviation of NAV from market value over 10 years or during the life of the fund if shorter than 10 years, since a principal characteristic of ETFs is that the arbitrage mechanism works effectively to minimize deviations from NAV. Investors need to be informed to what degree this mechanism is not working effectively and that their fund is not being correctly priced by the market. Two ETFs tracking the same index may have very different arbitrage efficacy, and investors should be able to compare them along this metric.

Fifth, another area in which registered funds potentially deviate in their valuation from market value occurs when registered funds invest in private securities (for example, pre-IPO start-ups). Different funds can ascribe these securities vastly different valuations, having a significant impact on the value of a fund's valuation. Since these securities are generally highly illiquid, they also impact a fund's liquidity. As a result, we recommend that the liquidity risk statement explain the valuation of private placements relative to those held by competitors. We also recommend that funds be required to explain their valuations of private securities relative to those of other funds on a historical basis. We have seen that funds can vary widely in their valuations for notable pre-IPO stocks, such as Uber[9] and Dropbox,[10] and the SEC has previously examined this issue noting that pre-IPO investing involves "significant risk for investors."[11]

d. We recommend shareholders be provided with more detail about holdings to inform investors about concentration and exposure risk.

The Commission proposes that funds disclose the total number of portfolio holdings as part of their required disclosures on fund statistics.[12] The Commission argues that this is an indication of portfolio risk.[13] We believe that investors would be better served by being provided information about the top 10 holdings of the fund and the percentage of the fund in each of these holdings. In this way, investors would be informed regarding potential concentration of risk. Assets should also be broken out by asset class to show net, short, and long positions.

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[9] Porzecanski, Katia 2017. "Vanguard Joins Funds Cutting Uber Share Price by as Much as 15%." Bloomberg. https://www.bloomberg.com/news/articles/2017-08-23/vanguard-joins-funds-cutting-uber-share-price-by-as-much-as-15 (explaining how markdowns by Vanguard Group, T.Rowe Price Group Inc., and BlackRock Inc. resulted in three distinct prices for Uber stock).

[10] McKenna, Francine 2015. "Here's why mutual fund valuations of private companies can vary." MarketWatch. https://www.marketwatch.com/story/heres-why-mutual-fund-valuations-of-private-companies-can-vary-2015-11-20 (explaining that "variation between the funds' assessment of the same private company investments" exists as a consequence of each fund's attempt to "assign a value to a custom security with unique terms," thus making it potentially "impossible to compare values across funds," and citing these discrepancies as "pervasive").

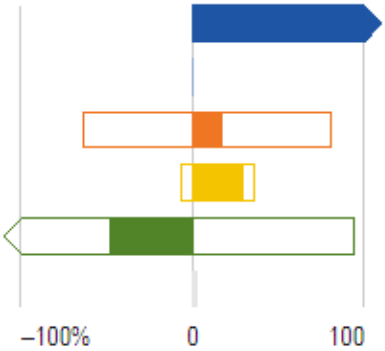
[11] SEC. 2005. "Risky Business: "Pre-IPO Investing." https://www.sec.gov/reportspubs/investor-publications/investorpubspreipohtm.html.

[12] Proposed Rule, P. 70746.

[13] Proposed Rule, P. 70747, F. 248.

The SEC should consider requiring the reporting of the long and short exposures by asset class rather than only the net allocation to better represent the exposures of the portfolio. For instance, Morningstar presents the holdings of Pimco StocksPLUS Funds shown in Exhibit 2 below. We believe that such a graphic is important to give investors a true sense of their exposures, not just asset allocation, accounting for the fund's use of derivatives. According to a study conducted by the SEC's own Division of Economic and Risk Analysis in 2015, 14% of mutual funds sampled reported derivatives holdings at or above 50% of net assets, indicating that derivatives are a significant component of exposure.[14] A pie chart of asset class allocation, by contrast, would not be as effective as an illustration as the graph below, as a pie chart could not depict negative or leveraged exposures.

Exhibit 2 – Asset Allocation for PIMCO StocksPLUS® Fund



Asset Class	Net	Short	Long
U.S. Equity	100.12	0.00	100.12
Non-U.S. Equity	0.23	0.00	0.23
Fixed Income	16.69	63.36	80.05
Other	29.32	6.87	36.20
Cash	-48.49	142.47	93.99
Not Classified	2.12	0.00	2.12

Data as of 6/30/2020

We recommend the Commission require funds that hold acquired funds, such as in a FoFs strategy, report their asset allocation based on the underlying holdings of the acquired funds. Looking through to the exposure of the underlying holdings will provide investors with the information they need to compare funds that directly invest in these markets and those that use acquired funds to achieve the same investment strategy. We suggest that the Commission provide clear guidance on how to account for acquired funds when calculating portfolio statistics such as asset allocation to ensure a consistent methodology across fund complexes. This guidance should address how many layers of acquired funds must be looked through and what is the minimum portion of the overall portfolio an acquired fund must represent to be relevant for these calculations.

We encourage the Commission to provide funds with a standardized format for showing exposures such that all funds use the same terminology and asset classes when illustrating their exposures. Such standardization, along with the tagging of this element (as we are requesting for all elements of the shareholder reports) would permit

[14] Use of Derivatives by Registered Investment Companies and Business Development Companies. (SEC) P. 11. https://www.sec.gov/rules/final/2020/ic-34084.pdf.

comparative analysis of exposure across funds, giving investors and the Commission useful insights about current and emerging market risks.

e. We recommend that investors be better informed about the board's obligations and management incentives.

We believe funds should disclose in the annual report how much the fund manager invests in the fund. This information indicates to the investor the extent to which the manager's interests are aligned with that of fund investors. Currently, information regarding each portfolio manager's beneficial ownership of shares in the fund is required to be disclosed in the fund's SAI, which is difficult for most investors to find.[15]

To echo the suggestions of Morningstar's fund board, we recommend the inclusion of language explaining to investors that they are owners in the fund and that portfolio managers work for them via an independent operating board. Shareholders should be reminded that board members represent their interests and be provided examples of the responsibilities of the board, such as the negotiation and approval of fees charged by the fund investment advisor. After all, the fundamental nature of an investment company is that independent directors represent the interests of shareholders. Information about whom the board members are and how to contact the board should be readily available. Since open-end funds rarely hold annual shareholder meetings, shareholders do not receive annual statements regarding the fund board and their governance. As such, "the only way that shareholders can learn about the board under the Proposed Rule is by actively seeking out two relatively obscure documents (SAI and Form N-CRS)."[16] We believe that board directors should, instead, be made more accessible through the annual shareholder report.

f. We recommend that expense reporting be simplified and made more comparable across funds.

We support the Commission's streamlined approach to informing investors about expenses. We recommend reporting an expense ratio in the shareholder report, as many investors are used to looking for this line item at a glance. The Commission should take this opportunity to alter the current annual report expense ratio to be more accurate and comparable across funds. We recommend it exclude interest expenses and dividends paid on short sales, as the Morningstar Adjusted Expense Ratio methodology has for some time.[17]

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[15] SEC. 2020. Form N-1A. Item 17, 34. https://www.sec.gov/about/forms/formn-1a.pdf.
[16] Independent Trustees of the Morningstar Funds Trust. 2020. Comment Letter. https://www.sec.gov/comments/s7-09-20/s70920-7923217-224588.pdf.
[17] "One Expense Ratio to Rule Them All." Morningstar. https://www.morningstar.com/articles/969612/one-expense-ratio-to-rule-them-all.

Removing interest and dividend expenses from the expense ratio gives investors a better sense for what a fund company is charging them for the cost of running the fund. Unlike the various operating costs a fund company deducts from fund returns—such as accounting, legal, and administrative fees; distribution costs; and the compensation the firm collects for managing the portfolio—the interest and dividend costs a fund incurs are a consequence of the investment decisions made by the portfolio manager, not unlike trading costs. Other trading costs, such as brokerage commissions, are not included. Excluding interest and dividend transactions allows funds with different types of investments to present their expenses in a comparable way.

Changing the threshold for displaying AFFE to 10% would result in investors being presented with misleading information that understates the cost of their investment. The prospectus expense ratio, which is forward-looking, should include AFFE and other specifics for FoFs. The threshold for displaying AFFE should stay where it is now. Allowing funds to only disclose these fees when the investment constitutes 10% or more of a fund is too high and would leave out too many acquired fees. Analyzing the most recent portfolios for all U.S. open-end mutual funds, we estimate that 5% of all funds would no longer include AFFE in their expense ratios with the proposed threshold. Specifically, we identified all funds that hold closed-end funds, ETFs, and open-end funds in their portfolios, where these positions represent at most 10% of the portfolio by assets, and where the fund currently reports AFFE. This cohort of over 350 funds represents over $500 billion in assets and the average AFFE generated by these small portions of the portfolios is 5.8 basis points. In 12% of these funds, the acquired funds account for more than 10 basis points in AFFE.

The shareholder report expense example should utilize the annual report expense ratio, as altered by our suggestion above to exclude interest and dividends, with a note explaining any differences with the prospectus expense ratio, as illustrated in Exhibit 3. The prospectus expense ratio may be different due to changes in management fees and the inclusion of AFFE, which we recommend that it should continue to include, as it does now. Using the annual expense ratio in the example allows the example to accurately reflect performance and cost for the past year, but it can obscure costs for investors in FoF portfolios—for example, target-date funds, which incur a significant portion of their expenses through AFFE. Presenting investors with the prospectus expense ratio in the report example as well ensures they are aware of the costs associated with this strategy and gives the fund a chance to address any other changes in the fees, such as reductions or increases in management fees. Since the shareholder report will be the primary document investors receive, we believe it is important that they are made aware of the total cost of their investment going forward in addition to being updated on the past year's performance.

Exhibit 3 – Mock-Up of Morningstar's Proposed Expense Example

What were your Fund costs for the period? *(based on a hypothetical $10,000 investment)*

Class	Beginning account value 2/1/2019	Total return before costs paid*	Costs paid†	Ending account value 1/31/2020	Costs paid as a percentage of your investment†	Ongoing annual fees as a percentage of your investment‡
Class A	$10,000	+ $723	- $78	= $10,645	0.77%	0.90%
Class Z	$10,000	+ $723	- $53	= $10,670	0.52%	0.65%

* Certain Fund expenses, such as those associated with buying and selling fund investments, reduced your total return.

† The costs paid during the period do not reflect certain costs paid outside the Fund (such as purchase charges you might have paid if you bought shares of the Fund during the period).

‡ More detail on the ongoing costs of the Fund can be found in the prospectus. This fee is accurate as of January 31, 2020. The difference of 0.13% in the costs paid for this period and the ongoing annual fee of each class is due to Acquired Fund Fees and Expenses (AFFE).

Apart from these recommendations, we believe that the Commission's example illustration of the new streamlined report is very helpful.[18] We think that the line item for the expense ratio should be retained as many investors are used to looking for a fund's expense ratio. The example illustrating the expenses as a percentage of a $10,000 investment is also instructive and aligns with the Client Relationship Summary (CRS), allowing investors to better understand their costs in a common context. The shareholder report should also include a prospectus expense ratio in the example to provide investors with an estimate of the ongoing total cost of the fund.

g. We recommend that investors be made aware of where they can obtain more information on material changes.

We recommend that notices to investors of material fund changes (e.g., manager change, fund name change) be improved to better explain the change and direct investors to the updated parts of the prospectus and SAI. The table of contents mentioned above would help with this goal and, if sufficiently clear, more context around material changes may not be needed.

II. Form N-CSR Data

a. We recommend that this data be structured to allow for comparative analysis.

We support the Commission's layered approach to disclosure and its decision to retain data that investors will not typically reference on the Form N-CSR. The Form N-CSR can serve as a data source for third parties and regulators to help investors compare information across funds in an objective way. As such, the Form N-CSR should be both

[18] Proposed Rule. SEC. 2020. Hypothetical Streamlined Shareholder Report. https://www.sec.gov/files/final_2020_im_annual-shareholder%20report.pdf.

human readable and in a structured data format (inline XBRL) with tags for all significant elements.

Specifically, we recommend that each item of the form be tagged so that, at a minimum, the block of text addressing each item can be found easily and analyzed through automated processes. As mentioned previously, Item 1 of the form N-CSR (the shareholder report) should be tagged in detail, with each element being tagged along with other specific information, such as principal risks, as discussed above. Since the shareholder reports will be much shorter than current annual reports, we believe that the benefits of such tagging outweigh the costs, which should not be significant.

Additionally, data elements in the financial statement, notes to the financial statements, and consolidated financials should also be tagged, as these pertain to fund fees and are, as such, critical for understanding and comparing fund operating expenses immediately after they are disclosed. Every data element should indicate the fund share class, fee type, and time period to which it applies. The notes to the consolidated financials should be tagged and linked to the data elements with which they coincide. All data should be inline XBRL so that data elements can be linked easily. We recommend that, going forward, the Commission use inline XBRL format for all of its data collection on forms to avoid the delays that occur when HTML and XBRL filings are made separately.

While the structure we have recommend thus far would allow third parties to process the filings, more-granular tagging would be necessary for individual investors to easily locate and compare data between funds. To support individual investors, we believe the Commission would need to further require all numerical values reported in the filing be tagged in inline XBRL with a consistent taxonomy, regardless of whether the values are disclosed in a table, figure, or paragraph.

III. Prospectus

a. We support the proposed changes to prospectus delivery.

We support the reduced frequency and volume of documents delivered to shareholders. Investors do not need to receive the statutory prospectus, and the summary prospectus is sufficient for investors who remain in the fund or purchase new shares in the fund. Access to the summary prospectus online is also appropriate unless investors ask to be sent the summary prospectus. The table of contents, suggested above, could be a critical resource in helping investors understand when they need to reference the statutory prospectus for information versus referencing the summary prospectus for the most current information.

b. We recommend changes to the fee table for clarity and completeness.

We support the SEC's use of simpler terminology in the new fee table. The SEC should include a transition key converting the old terminology to the new terminology for the first three years. The expense ratio in this table should include the gross expense ratio and net expense ratio. Both of these ratios should include AFFE and exclude interest expenses and dividends. The net expense ratio should continue to represent the gross expense ratio reduced by any fee waivers or rebates. The accounting for AFFE should be based on estimates from the previous period. Since the prospectus expense ratio is forward-looking, AFFE should be estimated using costs based on previous years or the best data available, as it does now. We believe that the expense example investors are provided in the annual report and in the fee table of the prospectus should be aligned with the fee table in the prospectus. Hence, as we discussed above, we are recommending that the prospectus expense ratio be reported in the shareholder report.

The differences in expense ratios investors observe today between the annual report and summary prospectus are confusing and deter investors from understanding and comparing potential investments. These inconsistencies also require third parties to conduct more cumbersome analyses and provide lengthier explanations when correcting expense ratios to reflect the true cost of investing. We recommend that interest and dividends cash flows be separate line items in the fee table. The AFFE estimate can also be a separate line item but should be included in the expense ratio. The table should clearly indicate which fees are being summed to obtain the expense ratio and which fees are excluded from this sum.

The current inline XBRL requirement for Form N-1A only applies to the "Risk/Return" sections found in the summary portion of the prospectus. We agree with the SEC's proposal to continue to provide structured data for the fees listed in the fee table. We recommend that the SEC require funds to tag the summary fee table using inline XBRL format in addition to the proposed Item 8A of Form N-1A ("Selling Fees") as it can act as a quality check to ensure consistency between the full fee table and fee summary. Furthermore, the tagging of the fee summary will allow the public, the Commission, and third parties to conduct comparisons across peers more accurately and more quickly.

IV. We recommend advertising literature be accurate and current regarding third-party ratings.

We applaud the SEC for strengthening advertising rules and making changes that better align with Financial Industry Regulatory Authority (FINRA) Rules 2210 and 2241. We think that integrating these rules into the fund advertising world will make advertising consistent across funds regardless of distribution channels. Whether advertising is distributed by a fund or by a broker-dealer should not impact the level of disclosures, and the SEC should ensure that the same standards are applied to funds as are applied to broker-dealers now via the FINRA rules. If the SEC chooses to strengthen advertising standards for funds beyond the requirements imposed on broker-dealers, it

should work with FINRA to align broker-dealer requirements to avoid regulatory disparities.

We recommend, in line with FINRA Rule 2241, that the SEC require that the use of third-party ratings in advertising not be misleading and be current. Funds should be required to display the most recent ratings information. They should specify whether the ratings information is based on the fund itself, the portfolio management team, or the fund company. Information, such as ratings and expenses, should be required to be representative of the specific fund and share class being advertised.

New funds seeking to illustrate synthetic performance prior to their inception should only be permitted to do so when they are related in specific ways to another registered fund. Such relationships would typically occur if a new share class is being launched for an existing fund or a predecessor/successor situation, where a fund changes its legal structure or domicile for business reasons. In the latter case, the original portfolio ceases to exist and substantially all shareholders are transferred into the new structure. In either case, funds should be required to explain the relevance of the synthetic data and the fee differences between the performance donor vehicle, from which the synthetic data came, and the new fund. Further, the donor performance should be adjusted to reflect differences in fees between the original fund and the new fund, in cases where the new fund has higher fees than the donor, and not adjusted at all if the new fund has lower fees. This approach will prevent any implication that the lower fees were achievable by an investor prior to the launch of the new fund. Such standards should be applied to all fund advertising regardless of whether this advertising is targeted directly to investors via fund companies or via a broker-dealer.

V. Form 497 in EDGAR

a. We recommend that no changes be made to the filing of Form 497 in EDGAR

The Commission has not proposed any changes to Form 497 and its filing and we agree. Third parties rely on critical information contained in this form, including material changes to fund management.

Conclusion

In summary, we support the Commission's layered approach to disclosure. We have a number of suggestions to make the annual report, particularly the performance and expense information, more useful to investors. We recommend aligning expense information between the summary prospectus and annual report. We have summarized these views above and answer specific questions posed by the Commission in the attached appendix. Furthermore, we urge the Commission to strengthen data collection and comparability by enabling more structured data and tagged elements. We also

recommend taking this opportunity to strengthen advertising requirements to ensure that investors receive accurate and helpful information in all fund advertising.

We thank the SEC for the opportunity to comment on the Proposed Rule. Should you wish to discuss any of the comments in this letter, please do not hesitate to contact any of us as indicated below:

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Jasmin Sethi at jasmin.sethi@morningstar.com or (617) 501-5446.
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Sincerely,

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Appendix A – Answers to Selected Questions from the Proposed Rule

Scope of Annual Report Disclosure (With Respect to Separate Series and Classes)

1. Would the proposed requirement that a fund registrant prepare separate annual reports for each of its series result in a shareholder report disclosure that is easier for fund shareholders to navigate and assess? If not, why not? Would requiring separate annual reports for each series increase the reports' relevance to shareholders and increase the likelihood that shareholders would read them? If not, why not? How would this proposed requirement affect the approach fund registrants currently use to prepare and transmit shareholder reports? Are there ways to modify the proposed instruction that would further improve disclosure for shareholders or reduce burdens for fund registrants? Instead of the proposed instruction, should we continue to permit fund registrants to prepare a single annual report that covers multiple fund series, as they may today? If so, why, and should there be any limits on the number of series for which information is presented?

> Morningstar supports the proposed requirement for fund registrants to prepare separate annual reports for each of its series and believes this will create a better experience for fund shareholders. Since the annual report will be the primary document shareholders receive, we believe it is important that the report is approachable and not overwhelming to shareholders while providing any necessary information and directions for accessing additional information. The requirement that annual reports be specific to each fund series will ensure that reports are a manageable length and only contain information relevant to the funds in which the shareholder is invested. While separation by series will likely increase the number of documents fund registrants produce, we do not believe it should significantly increase the total content fund registrants produce. Such separation will simply divide what is currently reported in one large annual report across many series-specific reports. Production costs should not significantly increase since each of the series-specific reports will be shorter under the proposed rule.

2. Are there certain types of funds for which a multi-series presentation in an annual report may be useful to shareholders? If so, which types of funds, and what are the benefits of a multi-series presentation to shareholders? Should we permit certain types of funds, but not others, to prepare annual reports covering multiple series of the same fund?

> For consistency, Morningstar recommends that all funds prepare annual reports that are unique to each series as we believe this will be most useful to shareholders and allow the report to be concise.

Scope of Annual Report Disclosure Content

5. Is it appropriate to restrict the content of a fund's annual report to include only the information the form would permit or require? If not, why not? Would these proposed limits on content create a more effective presentation for investors? Are there other approaches we should consider (such as permitting space in the annual report for funds to disclose other information they deem important to investors)? What are the benefits and drawbacks of shorter or longer disclosure, or a more flexible approach to disclosure, for investors relative to the proposed approach?

> Morningstar supports provisions that ensure the annual reports are kept to a reasonable length of three to four pages to make this document investor-friendly. Additionally, we believe it is important that this document be comparable for investors across funds and fund families. The inclusion of information and data beyond what is permitted or required by the form would likely extend the report and could easily introduce confusion for investors. Rather, we would recommend this additional information be included in another filing, to which the investor can be directed, aligning with the layered disclosure approach. If additional information or data is included in these filings, we believe it is important to consider what inline XBRL structure be required of this data to ensure it can be easily compared, analyzed and monitored to better understand how different funds are utilizing this section.

7. As proposed, should we allow a fund to modify a required legend or narrative information as long as the modified language contains comparable information? If not, why not? Should we use this approach for all aspects of the annual report, or are there particular areas where requiring uniform language across all funds' annual reports would be particularly valuable to shareholders, for example, to facilitate comparisons or improve shareholder understanding? If so, how should we balance the potential value of uniform language with potential concerns that uniform language may not be well-tailored to a particular fund or its shareholders?

> Morningstar recommends that the tagging of any information in inline XBRL be consistent across all funds and any aspects of the annual report. Maintaining consistency where possible in section headers so that investors can more readily consume reports since they may receive multiple reports is important. While some underlying statistics will change depending on what is relevant to the strategy, consistency in where shareholders can look on the report for different information is preferable to too much customization. We support interactive tools for investors; nonetheless, the report going into N-CSR must have the same tagged elements to allow investors and third parties to sufficiently compare funds.

Duplicate Information and Impact to Other Filings

8. Is it appropriate not to permit funds to incorporate information by reference into their annual reports, as proposed? If not, why not? Is there certain information that a fund should be permitted to incorporate by reference into its annual report? If so, what information, and why?

> Morningstar supports the proposal to not permit funds to incorporate information by reference into their annual reports as this method of including information can be confusing to shareholders. In order to enable shareholders to better locate pertinent information in their funds' documents, we recommend funds provide a table of contents for where to locate information across filings organized by topic. This resource could be provided online and referenced in the shareholder report as an additional option for navigating the documents available to them.

Cover Page and Beginning of the Annual Report

16. Is there additional information that we should permit or require funds to provide on the cover page or at the beginning of their annual reports? If so, what are the benefits of that additional information? For example, should we permit or require funds to include a table of contents, or would a table of contents add undue length to the shareholder report and provide limited benefits to shareholders given the general brevity of the report?

> Morningstar recommends providing the shareholder with a table of contents to one website maintained by the fund or fund complex where all documents will be available. We think it would be helpful to provide the investor with information in the annual report indicating where information on any topic (e.g., financial statements) can be found on the website. Currently, determining whether to look in the prospectus, SAI or another document altogether for specific detailed information is impossible to determine without going to each source. The location of information is not standardized, rendering document tables of contents provided by fund complexes largely unhelpful.

Expenses

18. Would the information that would be included in the proposed expense example permit shareholders to estimate the actual costs, in dollars, that they incurred over the reporting period and provide shareholders with a basis for comparing expenses across different funds? If not, why not? Which, if any, of the proposed disclosure requirements should we modify? Is there a better way of describing the fund's expenses to shareholders in the annual report?

Morningstar recommends excluding expenses tied to investment expenses, specifically interest expenses and dividends paid as part of short sales from the "Costs Paid" reported in the expense example to permit shareholders to more accurately compare expenses across different funds. This exclusion would distinguish investment expenses from operational expenses, drawing investor focus to the operational expenses that are more consistent over time and comparable across investment strategies.

19. Should we, as proposed, require funds to provide the costs in dollars associated with investing in the fund based on an assumed $10,000 investment? Should we increase the assumed investment amount from $1,000 to $10,000, as proposed? Should we use some other amount, and if so, what amount would be more appropriate and why?

Morningstar supports the proposed requirement for funds to provide the costs in dollars associated with investing in the fund based on an assumed $10,000 investment. We believe aligning the dollar amount used as the basis in this expense example with that used in the Form CRS will allow investors to more easily see the total cost of their investment decisions, covering account selecting, investment advice, and investment costs.

24. Should we require funds to provide the costs associated with investing in the fund as a percentage of a shareholder's investment in the fund (i.e., expense ratio)? Would this disclosure assist shareholders in comparing the level of current period expenses of different funds?

Morningstar supports requiring funds to provide the costs associated with investing in the fund as a percentage of a shareholder's investment in the fund as many investors are accustomed to seeing expenses expressed this way. Furthermore, this presentation could align with how expenses are reported by their investment advisor or broker-dealer, allowing them to more easily aggregate their costs of investing. Additionally, such expense ratio reporting would allow for comparability with previous disclosures where expense ratios are heavily utilized and where expense examples may have assumed different initial investment amounts.

Beyond representing the "Costs Paid" as reported in the expense example, we recommend requiring that the current prospectus expense ratio, which includes AFFE, be reported in the annual report to ensure investors are aware of the total cost of their investment. The annual expense ratio derived from the "Costs Paid" in the example allows can obscure costs for investors in FoF portfolios—for example, target-date funds, which incur a significant portion of their expenses through AFFE. Presenting investors with the prospectus expense ratio in the report example ensures they are aware of the costs associated with this

strategy, gives the fund a chance to address any other changes in the fee, such as reductions or increases in management fees, and provides a fee that is more comparable across various fund strategies.

29. Should we, as proposed, continue to allow a fund that is a feeder fund to reflect the aggregate expenses of the feeder fund and the master fund in the expense table and to include a footnote stating that the expense table reflects the expenses of both the feeder and master funds? Should we instead require feeder funds to separately disclose the fees associated with the feeder and the master funds, respectively?

Morningstar supports continuing to allow a fund that is a feeder fund to reflect the aggregate expense of the feeder and master fund in its expense tables. We believe such reporting allows investors to more easily understand the total expenses they are paying rather than focusing on at which level the fees are assessed. We recommend feeder funds identify their master fund by Series ID in the inline XBRL of the N-CSR to mirror the reporting of this data in the Form N-CEN. This will allow investors to easily seek out information on the master fund and remove confusion that could arise if only the master fund name were provided due to similarly named funds.

34. Should we require funds to submit interactive data files (for example, formatted using eXtensible Business Reporting Language ("XBRL")) containing their expense example information? Why or why not? Would it be useful for shareholders to have access to the expense example in a structured data format? Would this meaningfully complement the current requirement that funds submit their prospectus risk/return summary information in inline XBRL format, or would it be duplicative with this current requirement? Is there any other information from funds' shareholder reports that we should require funds to submit in a structured data format?

Morningstar believes the Commission should require funds to submit interactive data files in the inline XBRL format for the expense example. Including this data in a structured format allows third parties to aggregate these examples more readily and build tools that support investors seeking to compare investments. Additionally, this format would complement the current requirement that funds submit risk and return information in inline XBRL format, allowing for more information about the fund to be compared in aggregate.

46. We understand that the line graph can be difficult to read in black and white and may not fully illustrate volatility in the early years displayed in the graph. Are there other performance presentations that could better address these issues than the proposed approach and that would retain the benefits of the line graph presentation to shareholders? For example, should we replace the line graph with something similar to the bar chart required in fund prospectuses, which may be easier to read in black and

white? Would this alternative presentation better show year-to-year volatility? Is the risk/return bar chart easy for shareholders to understand, or do shareholders prefer the line graph presentation that shows returns in terms of dollars rather than percentages? If we were to replace the line graph with something similar to the risk/return bar chart, should that alternative presentation present returns in terms of dollars instead of percentages?

> While Morningstar has no specific research on this topic, we have reviewed the relevant risk literature.[19] In any graph, we recommend the inclusion of labels at each significant point because labels have been shown to improve the comprehension of risk and improve the user experience of the graph.

49. Should we require funds to provide information in shareholder reports about the performance of an appropriate broad-based securities market index, as proposed? What are the advantages and disadvantages of this information? Does information about an appropriate broad-based securities market index's performance provide investors with a helpful performance indicator of the overall relevant market? If so, do these benefits justify the burdens, including costs to the fund (and ultimately its shareholders) of paying one or more index providers to allow the fund to include this information in the fund's disclosure? Is cost a significant factor for funds when they determine which, and how many, indexes to include in their shareholder reports? How are these costs assessed (for example, are they assessed on a per-disclosure basis or on some other basis)?

> Morningstar believes the benchmark index should reflect the investment strategy. Using a broad-based index as the primary benchmark would reduce the potential for cherry-picking by funds. However, given that there are a wide variety of investment strategies within a given asset class, using a broad-based index would risk conveying an inaccurate comparison to the investor.
>
> We recommend against using a broad-based securities market index for all types of strategies. For multi-asset funds, we believe a multi-asset class index is more appropriate than a single asset class index. For single asset class funds, we believe using an index that represents the underlying investment strategy is more appropriate than using a broad-based index as proposed by the Commission.

Performance Presentations

50. Should we modify the definition of "appropriate broad-based securities market index," as proposed? If not, why not? If so, is the proposed definition appropriate, or

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[19] Okan, Y., Stone, E.R., & Bruine de Bruin, W. 2017. "Designing Graphs that Promote Both Risk Understanding and Behavior Change." Risk Analysis International Journal. https://doi.org/10.1111/risa.12895.

should we modify it in any way? For example, should we permit funds to use blended indexes only as secondary indexes, as proposed (as an index could be "broad-based" only if it represents the overall applicable equity or debt markets), or should we permit funds to use these indexes as primary appropriate broad-based securities market indexes under certain circumstances? If we were to permit this, what if any conditions would be appropriate to ensure that the index remains "broad-based"? For example, should there be requirements limiting a fund to the number of indexes that could be blended for this purpose (e.g., 2), or the types of indexes that could be blended? Similarly, should we modify current requirements that permit funds to use non-securities market indexes only as secondary indexes, and not as appropriate broad-based securities market indexes? Are there concerns with certain funds using blended indexes or non-securities market indexes as secondary, rather than primary, indexes, such as concerns about investor understanding or costs associated with disclosing multiple indexes (e.g., index licensing fees)? Do blended or non-securities market indexes provide an appropriate point of comparison for an investor to evaluate his or her fund's performance? If we were to allow blended indexes or non-securities market indexes as a primary index, how could we tailor this approach to make sure that investors receive a performance indicator of the overall applicable market? Is the proposed definition clear? For example, is it clear that an index composed of securities of firms in a particular industry or group of related industries would not be broad-based?

Morningstar does not recommend that the Commission modify the definition of "appropriate broad-based securities market index" as proposed as we believe this change would render the benchmarks less useful to investors. This proposed definition would narrow the scope of primary indexes to only those representing "the overall applicable domestic or international equity or debt markets." However, there are many funds with investment policies of a much more diverse scope. Restricting the set of indexes that these funds can use as their primary benchmark would result in investors being presented with misleading information as their funds' performance is compared to a noncomparable index. For example, a fund's investment policy could be to invest in value stocks. However, a value stock index would not meet the proposed definition for a broad-based securities market index. Therefore, the fund would be compared to a total market index which would be inappropriate given the different risks of these two investment strategies. Additionally, strategies that target specific allocations of multiple markets and those that are outcome-based are particularly ill-suited for comparison to a broad-based securities market index under the proposed definition.

Morningstar does not believe that blended indexes should only be permitted as secondary indexes, as proposed, since these indexes are more likely to provide a meaningful standard against which investors can measure their funds'

performance for a wide variety of strategies. We acknowledge the Commission's desire to provide investors with a more common broad-based securities market benchmark across funds and believe this goal could be achieved with the broad-based index (as proposed) being the secondary benchmark when such an index is not an appropriate match to the investment strategy, such as a target date or high dividends strategy.

53. Should funds have discretion to provide information in shareholder reports about the performance of more narrowly based indexes that reflect the market sectors in which the fund invests, as proposed? Is the information these indexes provide helpful to shareholders, or does additional index performance information make the disclosure more difficult for shareholders to understand?

Morningstar supports allowing funds to provide information in shareholder reports about the performance of more narrowly based indexes that reflect the market sectors in which the fund invests. The inclusion of these benchmarks is helpful to investors as it gives them a more apples-to-apples comparison between an index and a fund.

54. Should index providers be required to meet certain governance, due diligence, or other similar standards if an index's performance will be included in fund disclosure? Why or why not? If we imposed any such requirement, how would funds expect to determine whether those standards have been met?

Morningstar supports a requirement for index providers to meet certain governance, due diligence, or other similar standards if an index's performance will be included in fund disclosure as we believe this will enhance the quality and consistency of information available to investors. Specifically, we recommend that the Commission consider adopting requirements similar to those of the European Union's Benchmark Regulation. These guidelines have already been adopted by index providers with indices used by EU funds and similar regulation would provide for consistent governance, due diligence and other standards across markets and providers.

Statistical Information in Annual Reports

74. If a fund chooses to include in its annual report a statistic that Form N-1A requires the fund to disclose elsewhere, should we, as proposed, require such a fund to follow the Form N-1A instructions describing the calculation methodology for the relevant statistic? Should we place any additional limitations on the statistics funds would be allowed to include? For example, should we limit the number of additional statistics a fund could include? Should we specify the share class(es) tied to the statistics funds could disclose (e.g., require funds to include information only for the most expensive share class)? Should we only allow a fund to include a fund statistic that the fund

otherwise discloses to shareholders and reports to the Commission, such as information the fund includes on Form N-PORT, Form N-CEN, or in the fund's financial statements, prospectus, or SAI? Should we include an instruction that would prohibit funds from including information generated by third-party vendors, such as Morningstar or Lipper ratings or sustainability rankings? If so, why, and what should this instruction specify?

> Morningstar recommends that the Commission not add instructions prohibiting the inclusion of information generated by third-party vendors as we believe this information can help investors understand their fund relative to other similar products. Such information could include a rating that ranks the fund's past performance against funds with a similar strategy, a quartile ranking comparing a share class's expense to share classes with a similar strategy and distribution channel, and other quantitative or qualitative assessments meant to empower investors. However, we do believe that if funds include additional statistics or ratings in the annual report that do not comply with a specific SEC methodology, such as one from N-PORT or N-CEN, that the document should include information directing shareholders to where they can access information on the methodology of each statistic and rating. Additionally, if funds include information from third-party vendors, we believe this information should be required to be of the same time period as other statistics on the report whenever possible to ensure stale statistics or ratings are not used.

Portfolio Presentation

82. For funds that take significant derivatives positions or hold both long and short positions, would an exposure-based presentation help shareholders better understand a fund's holdings? Should we permit all funds to present their holdings on an exposure basis, as proposed? Should we require certain funds to present their holdings on an exposure basis? Why or why not? If so, for what types of funds and fund strategies would an exposure-based presentation be particularly useful? Should we be more prescriptive as to how to calculate exposure? If so, how? Should an exposure presentation be on a net or total basis or permit flexibility? Why or why not? Should we permit funds to pick how they present their holdings or should we prescribe when funds should use net asset value, total investments, net exposure, or total exposure? If we prescribe the basis of presentation, how should we determine which type of fund uses which type of presentation?

> Morningstar recommends that all funds present their holdings on an exposure basis. While this presentation is particularly useful for funds with derivative and leveraged positions, we believe displaying holdings data on an exposure basis is beneficial for funds with a wide variety of strategies. In addition to presenting exposure to asset classes, an exposure-based presentation of a portfolio can be

used to illustrate exposure to different countries based on the revenue of the companies issuing the holdings rather than based on the singular domicile of these companies. Taking this exposure-based approach provides a more accurate representation to investors of what risks an investment might encompass. We support requiring funds to show short, long, and net exposure to asset classes to provide a complete picture to investors about how their fund would interact with these markets.

84. Should we expressly permit or require other types of presentations, such as top 10 holdings or changes in holdings over time? If so, what types of presentations and why? If not, why not?

Morningstar supports expressly requiring that annual reports include additional presentations of holdings. Specifically, we recommend the report detail the percentage of the portfolio invested in the top 10 holdings and list these top 10 holdings. We believe this information will be valuable to shareholders in understanding how concentrated the fund's investment is and what holdings make up the portfolio. Additionally, we believe both of these elements can be incorporated into the reports without adding significantly to the overall length of the report.

Website Content Requirements

161. What is the appropriate time period for a fund to have to make the newly required Form N-CSR information available online? Should we, as proposed, allow funds to delay the availability of materials online by 70 days after the end of the relevant fiscal period? Because funds send their annual and semi-annual reports 60 days after the end of the fiscal period, should we similarly adopt a 60-day delay for the online accessibility of information that funds would file on Form N-CSR?

Morningstar recommends the Commission allow funds to delay the availability of materials online by 60 days after the end of the relevant fiscal period or up to the date the annual report is sent to shareholders, whichever is sooner. Morningstar supports the layered approach to disclosure and believes that aligning the timing of the release of information filed on Form N-CSR with the sending of reports to shareholders would best support this approach. Since the annual and semi-annual report shareholders receive will likely direct shareholders to the Form N-CSR, or information taken from it, this content should be required to be available online when shareholders receive the report. If there were an additional delay in making the Form N-CSR information accessible online, such a delay could stymie investors when reviewing their reports.

Scope of Costs and Performance Expenses

216. Is it appropriate not to require in the proposed summary or full fee table or example disclosure of brokerage commissions and other fees to financial intermediaries? Do commenters agree with our approach not to require such fees because financial intermediaries that distribute the fund typically determine such fees, and the amount may vary among financial intermediaries and distribution channels? Are there reasons such fees should be disclosed?

> Morningstar recommends that the annual report be required to make investors aware of whether the fund paid for research with "soft-dollars" and whether the fund or its adviser pay any fees to financial intermediaries who sell or distribute the fund. Furthermore, we recommend that the report provide direction to additional information in other fund documents if these arrangements exist, and that annual reports alert investors to reviewing the Form CRS from their advisor or broker-dealer for information specific to their relationship. While we agree that including fees to financial intermediaries in the shareholder report would be cumbersome and potentially inhibit the report from being the recommended three to four pages, we believe it is important that shareholders are alerted to the presence of fees that may create a conflict for the financial intermediary with which they work and the presence of soft-dollar fees that may indirectly reduce their returns.
>
> We recommend that the Commission require funds to report details on fees paid to financial intermediaries in the preceding year in a new item on the N-CSR. Current disclosure of fees to financial intermediaries in fund documents is often buried in lengthy filings, such as the SAI, and ensconced in conditional phrasing that make it difficult for investors to be aware of the conflicts of which they should be cognizant. Additionally, these disclosures are unstructured in their format, making it difficult for third parties to aggregate this data and to allow investors to process and compare intermediary compensation between funds more easily. Similarly, soft-dollar payments are only disclosed in absolute dollars in the SAI, without disaggregation of the cost of execution and the cost of research. Both the presentation and opacity of this data make it difficult for shareholders to understand the extent to which their fund pays for research with soft-dollars and the extent to which this reduces their returns.
>
> The Commission could improve transparency into these fees by requiring the shareholder report to alert investors to the presence of revenue-sharing arrangements and soft-dollar fees, and by providing additional details into these fees in the N-CSR. With respect to revenue-sharing arrangements, we recommend that the N-CSR contain a new tagged item that includes a list of financial intermediaries to which the fund paid compensation in the preceding

year, details on the amount of compensation paid to each intermediary firm, and the total dollars paid in revenue-sharing. This information would empower investors to question potential conflicts in the advice they are receiving and would enable the SEC and third parties to assess the impact of revenue-sharing on flows, similar to how Christoffersen, Evans, and Musto used payment data from the N-SAR to evaluate the impact of loads.[20] With respect to soft-dollar fees, we recommend these be disaggregated between the cost of execution and the cost of research. Separating the components of these fees will provide investors, the SEC, and third parties greater insight into how different funds manage these costs and if there is potential for investor harm.

217. Some investors commenting on the Fund Investor Experience RFC expressed interest in a single, "all-in" presentation of investment costs (or in personalized fee disclosure more generally) that would reflect both fund and intermediary costs. Other commenters indicated that preparing combined or personalized expense information could present some challenges, including the potential need for coordination and information-sharing between funds and intermediaries. Should funds provide more comprehensive fee and expense presentations that account for both fund and intermediary costs? If so, how? For example, are there ways we could better integrate information an investor receives about fund costs in fund prospectuses and information an investor receives about intermediary costs in a Form CRS relationship summary? If so, how? Should any integrated presentation of costs provide illustrative, standardized information about fund and intermediary costs, or should it provide investor-specific information? As another example, if a fund is only or primarily offered through one or more known wrap fee programs, should fund disclosure materials recognize the wrap fee program costs? Would this approach present challenges to funds or intermediaries? If so, what are those challenges, and how could we address them? If we modify fee and expense presentations to account for both fund and intermediary costs, should we also require performance information that recognizes both sets of costs? Would the proposed presentation of fees in terms of dollar amounts, in addition to the currently required percentage amounts, be useful to investors? Should an investment amount other than $10,000 be used? If so, what would be the appropriate amount?

Morningstar believes that a single, "all-in" presentation of investment costs, reflecting both fund and intermediary costs, would be extremely beneficial for investors. We recommend that this type of report be required of brokers and registered investment advisers, rather than of the fund companies. We believe that there are too many logistical challenges in requiring fund companies to prepare such a document. As there are many ways in which shareholders could invest in their funds, the "all-in" presentation would have to list each of these

[20] Christofferson, S.E.K., Evans, R., & Musto, D.K. 2013. "What Do Consumers' Fund Flows Maximize? Evidence from Their Brokers' Incentives." J. Finance, Vol. 68, No. 1, P. 201-235. https://www.jstor.org/stable/23324395.

alternatives. Such a presentation would, therefore, not be particularly personalized to any shareholder. Furthermore, the fund companies would likely not have access to all of the details of the intermediary costs their shareholders may pay. As a result, they would be unable to prepare an accurate report.

As an alternative, Morningstar suggests that the Commission consider whether the Form CRS could be expanded to encompass this personalized, "all-in" presentation of investment costs. Investors could then see the difference between holding certain funds in a brokerage account or an advisory account to get a true sense of their portfolio expenses.[21] If the brokers or advisors were to prepare this information, they could evaluate the cost of all investments in their client portfolios, weigh the investment expenses by the proportion of the portfolio that each represents, and combine this with the details on the fees the clients pay them. We believe providing investors with a report that holistically considers the costs of their investments and the intermediaries with whom they work would facilitate investor education and enable them to be more active participants in managing their investments.

219. As proposed, the "Transaction Fees" heading in the summary fee table would include specified line items: Purchase Charge, Exit Charge, Maximum Purchase Charge Imposed on Reinvested Dividends, Early Exit Fee, and Exchange Fee. Should the "Transaction Fees" heading include all of these line items, or should the Commission limit this fee presentation in any way (e.g., by only permitting a fund to include the purchase charge and exit fee in the summary fee table)? Would the proposed inclusion of all of these line items detract from a focused presentation of transaction costs? Do commenters agree with our expectation that most funds would not include all of these line items, given the proposed instruction that any transaction fee equaling $0 should not be included?

Morningstar supports the inclusion of the proposed specified line items in the "Transaction Fees" heading in the summary fee table. We do not believe that the inclusion of all of these line items would detract from the presentation of transaction costs, and we believe it is important that investors are informed about how their transaction decisions will impact their investment costs in line with these scenarios. Additionally, we believe very few funds will need to report multiple line items in this section. Considering the most common transaction fee types – Purchase Charges, Exit Charges and Early Exit Fees – we find that currently, only 1% of mutual fund share classes have more than one

[21] See Sethi, J. 2020. "Can We Finally Empower Investors With Plain English Fund Disclosure?" https://www.forbes.com/sites/jasminsethi/2020/09/04/can-we-finally-empower-investors-with-plain-english-fund-disclosure/?sh=2a47091346c7 (explaining how such an expanded CRS would be helpful to investors).

of these fees, with these share classes representing less than 1% of mutual fund assets as of November 30, 2020.

221. Is it appropriate to require a fund to indicate the highest amount that the fee could be (and to state in its disclosure, as proposed, that a particular fee is "up to" that amount if the fund offers fee discounts)? Is this an effective means of indicating that charges may be lower than the maximum fee that the fund discloses in the summary?

Morningstar believes it is appropriate for a fund to be required to indicate the highest amount that a fee could be and, as proposed, use the keywords "up to" to indicate that this number represents a maximum rather than a fixed fee. We believe this presentation will be an effective means of indicating that the charges may be lower if the "up to" is sufficiently visible next to the maximum fee rather than in a footnote.

222. Is the proposed optional "Ongoing Annual Fees with Temporary Discount" line item appropriate? If so, is it also appropriate to require a fund to disclose the gross figure before any such waivers, as proposed? Should these two line items appear adjacent to one another in the summary fee table, as proposed?

Morningstar agrees that it is appropriate for a fund to optionally be able to disclose the ongoing annual fees with a temporary discount and that it be required that this is disclosed in conjunction with the gross figure before any waivers. Placing these line items in close proximity on the report should highlight to investors the differences and raise questions if they are unsure whether the fee is applicable to their investment.

223. Should we modify the types of fund costs that funds currently must include in their expense ratios, which funds would disclose in the proposed summary fee table and the full fee table? For example, should the reported expense ratio include any performance expenses—such as securities lending costs or fund transaction costs—that it does not currently include? If so, how should funds measure each newly disclosed category of performance expenses? For example, should securities lending costs be disclosed as a percentage of net assets in the prospectus, based on current disclosure of these costs in the SAI? Alternatively, should performance expenses that are currently included in the expense ratio, such as interest expense or dividends paid on short sales, not be included as a component of the expense ratio? Should the presentation distinguish between direct fees and expenses (i.e., operating expenses) versus performance expenses associated with portfolio management activities that detract from fund performance (such as interest expenses, dividends paid on short sales, AFFE, securities lending costs, and fund transaction costs) and, if so, how?

Morningstar recommends that the Commission modify the types of fund costs that funds include in their expense ratios to ensure more comparability across investment strategies. To this end, we suggest that the reported expense ratio

exclude interest expense and dividends paid on short sales as these are performance expenses rather than operational costs and will differ drastically across strategies and asset classes. However, we support the continued inclusion of AFFE in the expense ratio, as the current AFFE disclosure requirements indicate this cost to be a meaningful amount.

Changing the threshold for displaying AFFE to 10% would result in investors being presented with misleading information that understates the cost of their investments. We estimate that 5% of all U.S. open-end mutual funds would remove AFFE from their expense ratios with the proposed threshold, based on their most recent portfolios. Specifically, we identified all funds that hold closed-end funds, ETFs, and open-end funds in their portfolios, where these positions represent at most 10% of the portfolio by assets, and where the fund currently reports AFFE. This cohort of over 350 funds represents over $500 billion in assets and the average AFFE generated by these small portions of the portfolios is 5.8 basis points. In 12% of these funds the acquired funds account for more than 10 basis points in AFFE. These are non-negligible fees that should be reported to investors.

Regarding securities lending, we do not believe that the expenses need to be included in the fee table. Securities lending serves as both a cost and a source of revenue for funds. The net effect of securities lending is captured in the fund return. Including the cost of securities lending, generated through interest charges, would be misleading to investors because the revenue raised from these activities would not be listed as an offset.

230. Are there ways we could reduce complexities associated with funds offering multiple share classes with different fee structures? For example, should funds more clearly present their classes based on investor eligibility? What are the challenges of such an approach?

As the shareholder reports will include share classes that may be cheaper than the share class in which an investor is currently invested, we believe it would be beneficial if a fund provided a brief description of the share class availability and investor eligibility requirements for each share class. This would allow investors to understand if there is an opportunity for them to move to a more appropriate share class and when the alternatives may be unavailable to them, such as a share class limited to distribution through retirement plans. If there are a large number of share classes for a fund and including these descriptions would inhibit the report from remaining a reasonable length of three to four pages, we would support the report directing shareholders to where to find this information online or in other fund documents, provided the directions to locating the information in the fund documents are sufficiently specific.

Proposed Simplified Example

232. Is the proposed simplified example presentation appropriate, and would it be useful to investors? Would restricting the example to including expense information for one- and 10-year periods accomplish the goal of streamlining the fee summary, while providing meaningful disclosure? Should the simplified example include different time periods, and if so, which ones? Is the proposal to require new funds to present expense information for one- and three-year periods appropriate?

> Morningstar believes the proposed simplified example presentation removes important information and would ultimately be less useful to investors than alternative options. We propose that rather than restricting the example to one- and 10-year periods, the example include one-, three-, five-, and 10-year periods, as available. This would allow investors to understand the cumulative expense over short, medium, and long holding periods while not significantly increasing the space needed to communicate this information. As almost half of active share classes have a track record of less than 10 years, the five-year return provides investors a longer time-horizon than just the one- and three-year returns. Further, not all reports would be lengthened by this performance display in light of the length of the life of each fund. We support the proposal to require new funds with less than five years of fund history to present expense information for one- and three-year periods.

236. Do the different presentations of fund fees and expenses in prospectuses and shareholder reports currently contribute to investor confusion? Would our proposed amendments to fee and expense presentations in both documents increase, reduce, or have minimal effect on the potential for investor confusion? How could we modify the presentations to reduce the potential for investor confusion? For instance, one difference is that the prospectus fee table may reflect the costs associated with investments in other funds (i.e., AFFE) while the annual report does not directly reflect these expenses. For example, a fund of funds may show an expense ratio of 0.20% in its annual report but reflect expenses of 1.00% in its prospectus fee table because the prospectus presentation also reflects the costs associated with investment in other funds. How can we address these differences to minimize the potential for investor confusion?

> Morningstar believes that the different presentations of fund fees and expenses in prospectuses and shareholder reports currently contribute to investor confusion. In particular, the exclusion of AFFE from shareholder reports causes confusion as for many funds these expenses comprise a significant portion of their expenses. Consequently, a large disparity could exist between the expense ratio reported in the prospectus, which includes AFFE, and that reported in the annual report, which does not.

Morningstar believes that the proposed amendments do not fully address this confusion as they do not update the treatment of AFFE in the expense information included in the shareholder report. We acknowledge that it is often not possible for a fund to calculate the total "Costs Paid" for AFFE in a previous year for easy incorporation into the expense example, but we believe it is crucial that investors be informed of the AFFE of their fund in the shareholder report in some manner, both to reduce confusion and to ensure they understand the total cost of their fund on an ongoing basis.

Morningstar recommends that the fund expense and fee information in the shareholder report be supplemented by also reporting the prospectus expense ratio. This would provide investors with the current ongoing total cost of their fund, incorporating the sometimes large AFFE. In the proposed expense example, AFFE would be noted as a cause for reduced returns but would not be included in the reported expense ratio. We recommend the expense example be expanded to include the prospectus net expense ratio next to the annual report expense ratio. Since the shareholder report will become the primary communication shareholders receive, this communication would ensure that for all funds shareholders are aware of the cost of the fund going forward, which could differ significantly from the expense ratio based on the cost paid in the last year.

AFFE Disclosures

239. Should we amend AFFE disclosure requirements to allow funds that invest 10% or less of total assets in acquired funds to omit the AFFE amount from the fee table and instead disclose the amount of a fund's AFFE in a footnote to the fee summary and fee table, as proposed? If not, why not? Instead of permitting funds with limited acquired fund investments to disclose the amount of a fund's AFFE in a footnote, should we require all such funds to disclose AFFE in a footnote? Would a mandatory approach reduce, increase, or have no effect on the potential for investor confusion relative to the proposed approach? Should we permit or require all funds, regardless of the magnitude of their acquired fund investments, to include AFFE in a footnote?

Morningstar does not recommend the Commission amend the current AFFE disclosure requirements to allow funds that invest 10% or less of total assets in acquired funds to omit the AFFE amount from the fee table and relocate this to a footnote. The costs of the acquired funds can be quite high, such that 10% of total assets invested in these funds still results in a significant expense to the fund. Our analysis of funds that invest in acquired funds where these positions sum to less than 10% of total assets finds the average reported AFFE to be nearly six basis points. As a result, relocating this information to a footnote essentially removes important fee information as many investors will overlook

the footnote and thus not appreciate the overall cost of the fund. Additionally, we do not see any issues with the current AFFE disclosure requirements in terms of when these fees must be disclosed that makes amending these requirements necessary at the present time.

246. As another alternative, should we permit a fund to disclose AFFE in a footnote to the fee table, instead of in the fee table itself, if the amount of the fund's AFFE is below a certain threshold? If so, what threshold should we use for determining when a fund's AFFE is sufficiently small, relative to its other expenses, such that the fund does not need to include AFFE in the fee table? For example, should we permit a fund to disclose AFFE in a footnote to the fee table if the amount of its AFFE was less than a specific percentage of its annual ongoing fees (excluding AFFE) or average net assets? If so, what specific threshold should we use, and why? Would this approach improve the utility of the disclosure for investors? How would this approach affect the consistency of the fee table disclosure, relative to the proposed approach? For example, would it result in AFFE amounts moving in and out of the fund's ongoing annual fee figure at a greater or lesser frequency than the proposal?

Morningstar does not recommend permitting a fund to disclose AFFE in a footnote to the fee table, as an alternative, if the amount of the fund's AFFE is below a certain threshold. We believe that the current AFFE disclosure requirements ensure all significant AFFE is reported in the primary fee table and that it is important investors continue to receive this information with the same granularity and clarity going forward. If this information were moved to a footnote it would very likely be overlooked by investors.

Prospectus Disclosure Requirements

258. Is the proposed new instruction to Item 4(b)(1)(i), providing that a fund in a complex should describe principal risks in order of importance, appropriate? Is it helpful to expressly provide in the proposed instruction that a fund may use any reasonable means to determine the significance of the risk? Should the proposed instruction be more prescriptive as to how a fund should determine the significance of risk, and if so, what method for determining risks' significance should the instruction specify (for example, should the proposed instruction specify ways in which a fund could—or must—quantify likelihood and severity of risk, and if so what methods for quantification should the instruction specify)? Should additional guidance be provided? Is it appropriate to expressly state in the proposed instruction that a fund should not list its principal risks in alphabetical order? Are there circumstances where an alphabetical order presentation may be appropriate and if so which ones?

Morningstar believes that the requirement that principal risks be described in order of importance is appropriate and beneficial to shareholders. Additionally, we believe it is appropriate to expressly state that the principal risks should not

be listed in alphabetical order, and we support the report explicitly stating that the risks are listed in order of importance to ensure investors are aware of the reasoning for the non-alphabetical order. Since disclosure currently and generally has risks in alphabetical order, we believe it is important that investors understand the new instructions during the transition and that new shareholders continue to be notified of the significance of the order. We would support the inclusion of additional guidelines on how funds should determine the significance of risk so that approaches taken by different fund complexes are sufficiently similar to allow investors to compare the placement of risks between funds.

264. Are there other changes we can make to risk disclosure to make this information more investor-friendly, clear, and succinct?

Morningstar believes that it is vital that investors understand the risks of their investments and be able to compare these across investment options. To that end, we suggest providing a more definitive taxonomy for risks to ensure they are identified with a similar scope and name across fund complexes. Furthermore, we strongly recommend improving the XBRL tagging of risks so that each is marked individually rather than collecting all risk disclosure under one tag. This tagging would allow for each risk to be structured as a name, description, and rank, and for this data to be more easily disaggregated by the Commission and third parties to support tools allowing investors to compare investments.