DrinkerBiddle

Client Alert

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SEC Guidance Advises Funds to Review and Update Risk Disclosures Regarding Market Conditions

The staff of the SEC's Division of Investment Management has released guidance recommending that funds review their risk disclosures on an ongoing basis and update them, as necessary, to reflect changes in market conditions. The guidance notes that if there has been a change in a fund's risks that would be material to investors, the fund should take steps to ensure the change is communicated appropriately to investors, particularly with regard to the fund's prospectus, shareholder reports, website, and marketing materials. Additionally, the staff writes that fund advisers should consider providing fund boards with information detailing the adviser's process for evaluating the adequacy of current risk disclosures and determining whether any updates are needed.

Market Related Risk Disclosures. The guidance goes on to discuss two areas where the staff believes changing conditions may necessitate additional or modified risk disclosure: (i) for fixed income funds, disclosures related to interest rate risk, liquidity risk and duration risk; and (ii) investments in Puerto Rico debt securities. The staff cites with approval various risk disclosures that funds have adopted in response to the current period of historically low interest rates and the risks associated with a potential rise in interest rates. According to the staff, such risks may include a decline in the value of a fixed income fund's investments, increased fund redemptions that may force funds to sell securities at disadvantageous times and prices, and that changes in interest rates will have a greater impact on securities with longer durations.

Puerto Rico Debt Disclosures. The guidance also commends funds that have updated, where appropriate, their risk disclosures to reflect the heightened risks associated with Puerto Rico debt securities. By way of example, the guidance notes that some funds have provided disclosures describing Puerto Rico's current financial difficulties, including its significant budget deficit, and recent downgrades of its debt rating. The staff also observes that many tax-exempt funds with single state names (*e.g.*, the Florida Tax-Exempt Fund) may have significant exposure to Puerto Rico debt and should consider whether the associated risks are adequately disclosed.

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The guidance is not groundbreaking but instead is a reminder of board and adviser fiduciary duties to fund shareholders in volatile markets. Responsibility for the accuracy of the disclosures in a fund's registration statement rests with the fund, and by extension, the fund's board. Boards may therefore want to consider receiving more frequent and/or in depth reports on risk disclosures from the adviser and counsel based on prevailing market conditions.

For more information about this alert, please contact the Drinker Biddle Investment Management Group lawyer with whom you regularly work.

Investment Management Group