

MEMO# 6585

January 20, 1995

INSTITUTE LETTER TO SEC STAFF ON STANDARDIZED RISK MEASURES

January 20, 1995 TO: BOARD OF GOVERNORS No. 14-95 SEC RULES COMMITTEE No. 9-95
RE: INSTITUTE LETTER TO SEC STAFF ON STANDARDIZED RISK MEASURES

The Institute recently submitted a letter to the SEC staff to express its preliminary views on the feasibility of adopting a standardized measure of risk for mutual funds. A copy of the letter is attached. The letter states that, while the Institute is strongly in favor of providing investors with clear and effective risk disclosure, "none of the [risk measurement] approaches suggested to date is without problems and it remains to be demonstrated that any of them will serve and advance the interests of fund shareholders." Accordingly, the letter recommends that the Commission proceed cautiously on this project, and that it issue a general concept release on this issue before making a formal rule proposal. The letter sets forth the following as preliminary conclusions based on the deliberations of the Institute's task force: (1) because "risk" is a multifarious concept, it is not feasible to develop a single, all-encompassing measure of a mutual fund's risk; (2) it is imperative that any measure ultimately adopted be transparent and readily explicable to the investing public; (3) measures such as duration that focus only upon certain risk factors (e.g., interest rate risk) are apt to be more misleading than illuminating; and (4) historically based measures of volatility such as standard deviation raise some difficult issues that require further study. The letter suggests that as an alternative to requiring funds to disclose their average portfolio duration, the Commission consider requiring funds with a stated maturity policy to have commensurate average portfolio durations, at least under normal market conditions. (For example, a fund with "short term" in its name could be required to have an average portfolio duration of less than 3 or 4 years.) The letter recognizes, however, that several significant matters would first have to be resolved, most notably the development of some standardized methodologies for computing duration. We will keep you advised of developments as the Commission continues its consideration of this issue. Paul Schott Stevens General Counsel Attachment