MEMO# 5407

December 16, 1993

INSTITUTE LETTER TO SEC ON MUTUAL FUND VOLATILITY RATING

December 16, 1993 TO: SEC RULES COMMITTEE NO. 111-93 SUBCOMMITTEE ON ADVERTISING NO. 21-93 RE: INSTITUTE LETTER TO SEC ON MUTUAL FUND VOLATILITY RATING ____ As you may know, several nationally-recognized statistical rating organizations are reportedly developing "volatility ratings" that purport to measure the sensitivity of a bond fund's net asset value to changes in interest rates. We understand that the Division of Investment Management is considering whether to permit the inclusion of the proposed volatility ratings in mutual fund advertisements. The Institute recently sent the attached letter to the Division, urging the staff not to approve such a use of the ratings. In its letter, the Institute expressed its strong support for the objective of providing meaningful investment risk disclosure to investors, but stated that the volatility ratings "would be an improper projection of future performance, could mislead investors about investment risk, and would provide them little, if any, useful information concerning a fund or funds in which they may consider investing." The letter points out that current SEC rules prohibit the use of such ratings in mutual fund advertisements. Moreover, since the ratings would be determined by analyzing a fund's current portfolio, they quickly could become out of date as the portfolio or the adviser's investment methods change. In addition, there is a significant danger that investors will place too great a reliance on the rating as the only or the most relevant presentation of the fund's risk. Finally, the rating could lead investors to view the rating as promissory in nature. Thomas M. Selman Assistant Counsel Attachment