MEMO# 6813

March 31, 1995

SEC CONCEPT RELEASE ON IMPROVING MUTUAL FUND RISK DISCLOSURE

March 31, 1995 TO: SEC RULES COMMITTEE No. 50-95 RISK DISCLOSURE TASK FORCE RE: SEC CONCEPT RELEASE ON IMPROVING MUTUAL FUND RISK DISCLOSURE ____ The Securities and Exchange Commission has issued a concept release requesting comment on how to improve risk disclosure for investment companies, including ways to increase the comparability of disclosure about fundsG risk levels through quantitative measures or other means. In addition, the SEC has issued a summary of the release requesting comment from individual investors on ways to improve the descriptions of mutual fund risks. A copy of the CommissionGs concept release is attached, which includes as an appendix a copy of the investor release. Comments are due on the concept release by July 7, 1995. We intend to schedule a meeting shortly to discuss the issues raised in the release. The significant aspects of the SECGs release are summarized below. 1. The Goals of Risk Disclosure The SEC has solicited comment on a variety of issues dealing with the fundamental question of what “risks” should be disclosed to investors. For instance, comment is requested on the extent to which “investors [are] concerned with the likelihood that they will lose principal, that their return will not exceed a specified benchmark (such as the Standard & PoorGs 500), or with the variability of their returns (or the volatility of the value of their investment) over time.” Comment is also solicited on the nature of risk comparisons that are useful to investors (e.g., whether risk disclosure should facilitate comparison between funds and other investment products, among all types of funds, among particular fund types or only among funds with similar investment objectives and policies). In addition, comment is requested on whether improved disclosure of risks is equally important for all type of funds (e.g., equity, fixed-income, asset allocation funds) and the degree of detail regarding fund risk that should be communicated to investors. 2. Narrative and Non-Narrative Risk Disclosure Options Comment is solicited generally on the relative merits and usefulness of various formats for investment company risk disclosure, including narrative disclosure, quantitative measures, graphs, tables and other pictorial representations. In addition, comment is requested on a number of specific issues regarding the use of these various approaches, which are summarized below. a. Narrative Disclosure Options - The Commission requests comment on the usefulness to investors of the narrative risk disclosure currently found in prospectuses and on ways of improving that disclosure. For instance, comment is requested on whether prospectus disclosure should focus on the broad investment strategies of a fund rather than the particular investments used to implement the strategy. b. Quantitative Measures of Risk - The Commission has solicited comment on a number of different quantitative risk measures. Specifically, comment is requested on measures of “total risk,” which, as described in the release, “quantify the total variability of a portfolioGs returns around, or below, its average return.” These measures include standard deviation of total return and semi-variance, which measures the variability of returns below the average return. The Commission also has solicited comment on the usefulness of market risk measures, such as beta, duration and various risk-adjusted measures of performance (i.e., Sharpe Ratio, Treynor Ratio and JensenGs Alpha), which are described in the release. In addition, separate nd apart from durationGs potentil use as a quantitative risk measure, comment is solicited on whether a fundGs name or investment objective that refers to the maturity of its portfolio, such as “short-term,” should be required to be consistent with the duration of its portfolio. c. General Issues Concerning Quantitative Measures - The Commission requests input on a number of general issues relating to quantitative risk measures, including (1) their potential benefits and associated costs and burdens, (2) whether quantitative risk measures currently used by investment companies for internal purposes could be adapted for disclosure purposes, (3) the difficulties that investors would face in properly interpreting various quantitative risk measures, (4) issues dealing with the computation of quantitative risk measures, (5) whether, and how, disclosure of risk measures might influence portfolio management (e.g., could they cause a fund manager to adopt more conservative investment strategies?), (6) the usefulness of SEC-required disclosure in light of the availability of quantitative risk information from third party providers and (7) whether the SEC should take steps to facilitate the dissemination of fund risk information by the financial press and other parties (e.g., by requiring more frequent or more detailed descriptions of fund portfolio holdings). 3. Self-Assessment of Risk Another alternative on which the Commission seeks comment is self-assessment by funds of their aggregate risk level (e.g., a description of where the fund fits on a risk scale from low to high). Comment is requested on whether the SEC should create a standard scale for these purposes and, if so, what that scale should be. 4. Risk Management Procedures The Commission has solicited comment on whether disclosure of fund risk management procedures should be required. For example, should funds describe the “stress-testing” they do to determine how the portfolio will behave in various market conditions? 5. Liability Issues Comments are requested on the appropriate scope of, and limits on, the liability of funds, investment advisers, and others for various risk disclosures. * * * Amy B.R. Lancellotta Associate Counsel Attachment