

MEMO# 8480

December 20, 1996

INSTITUTE SUBMISSION TO SEC STAFF PROPOSING A METHODOLOGY FOR CALCULATING PORTFOLIO DURATION

1 See Memorandum to SEC Rules Committee No. 87-96 and Risk Disclosure Task Force, dated July 31, 1996. December 20, 1996 TO: SEC RULES COMMITTEE No. 133-96 DURATION TASK FORCE RE: INSTITUTE SUBMISSION TO SEC STAFF PROPOSING A METHODOLOGY FOR CALCULATING PORTFOLIO DURATION

As you may recall, the Institutes comment letter on the Securities and Exchange Commissions risk disclosure concept release included a recommendation that funds that hold themselves out as having a stated maturity policy be required to have a commensurate duration policy.¹ The letter noted that if the Commission pursued this recommendation, a standardized methodology for calculating average portfolio duration would need to be developed. Subsequently, the Commission staff solicited the Institutes recommendations regarding a uniform methodology for funds to use in calculating their portfolio duration. Attached is a paper that sets forth the preliminary recommendations for calculating duration developed by the Institutes Duration Task Force, which was recently submitted to the Commission staff. The Task Force recommended a general methodology (empirical duration) for determining a funds duration. This methodology requires that funds estimate the value of portfolio securities based on current and assumed changes in interest rate levels. The paper recognizes that the methodology for making these estimates of value varies depending upon the security type and that a significant degree of subjectivity is involved in the process. Accordingly, the paper recommends that funds be given sufficient flexibility regarding the valuation of portfolio securities for purposes of determining duration. The Task Force recommended, however, that funds follow certain general principles in determining the duration of different types of portfolio securities (i.e., bonds without embedded options, bonds with embedded options, interest rate linked derivatives and adjustable rate instruments). With respect to the duration limitations that funds should be required to meet, the Task Force recommended the following: (a) not more than 3 years for short-term funds; (b) 1.5 to 4.5 years for short-intermediate term funds; (c) 2.5 to 9 years for intermediate term funds; (d) 5 to 12 years for intermediate long-term funds; and (e) over 5 years for long-term funds. These limitations are designed to correspond with the maturity limitations that the staff currently imposes upon a fixed-income fund that has a name reflecting a maturity policy. The Task Force recommended that funds be required to comply with the duration limitations only under normal market conditions. The Task Force also recommended that funds adopt written procedures describing the methodology used for calculating each type of portfolio security they own. Finally, the Task Force

recommended that funds adopt written procedures reasonably designed to ensure compliance with the applicable duration limitations, which should include, among other things, specified intervals at which a funds portfolio duration would be measured. We are interested in any comments you may have on the Task Forces preliminary recommendations regarding the methodology for calculating duration for a possible future submission refining these recommendations. If you have any comments, please call me by January 31, 1997 at 202/326-5824 or e-mail me at amy@ici.com. Amy B.R. Lancellotta
Associate Counsel Attachment

Source URL: <https://icinew-stage.ici.org/memo-8480>

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.