Institute Offers Recommendations on Improving Risk Disclosure, August 1996

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Washington, DC, August 1, 1996 - The Investment Company Institute today released a summary of its response to the Securities and Exchange Commission's concept release seeking comment on ways to improve investor understanding of risk in mutual funds. The Institute offered three specific recommendations, which are the result of a year-long effort by a broad range of investment company industry representatives to provide clear and effective risk disclosure to investors. The Institute's recommendations are:

- Improve narrative disclosure by focusing on the overall risk of the fund rather than on the risks of the individual securities in the fund's portfolio.
- Require that each prospectus include a bar graph showing the fund's annual total return for each of the previous 10 years.
- Require that any fund that identifies itself either in its name or in its marketing material as having a stated maturity policy to have a corresponding portfolio duration policy.

The Institute also expressed its "adamant opposition" to a requirement that funds report a single, standardized, numerical measurement of risk. ICI research indicates this approach is flawed because it ignores the fact that risk is a multifaceted concept having different meanings to different investors, Institute General Counsel Paul Schott Stevens said. Further, investors are likely to rely heavily on such a measurement to make investment decisions without understanding its characteristics and limitations. This over-reliance on a single, numerical measure, to the exclusion of other important information about a mutual fund's risks, could cause investors to understand even less about the fund's risks than had the number not been provided and, as a result, make inappropriate investment decisions, Mr. Stevens noted.

"It is essential that investors understand the various elements of risk, including the concept that risk and long-term reward are closely related, and that they understand it may be necessary to assume certain risks to achieve long-term investment rewards," Mr. Stevens said.

"The Institute has long been a proponent of effective risk disclosure to mutual fund investors, including efforts begun two years ago to educate the public about bond funds and risks that bond fund investors may encounter from changes in interest rates," Mr. Stevens noted. "The mutual fund industry believes that its latest recommendations, when taken together, will significantly enhance investor understanding of mutual fund risks."

Of the three recommendations, the use of bar graphs to illustrate a fund's total return—an outgrowth of the industry's recent profile prospectus project— could prove to be the most beneficial for investors. "The use of a chart to graphically depict a fund's total return over time will be a great help to those investors for whom a picture is worth a thousand words," Mr. Stevens said.

The Investment Company Institute is the national association of the American investment company industry. Its membership includes open-end investment companies ("mutual funds"), closed-end investment companies, and sponsors of unit investment trusts. Its mutual fund members have assets of about $2.4 trillion, accounting for approximately 95% of total industry assets, and have over 38 million individual shareholders.