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Securities and Exchange Commission
100 F St. NW
Washington, DC 20549-9303
Rule-comments@sec.gov

Re: Tailored Shareholder Reports

File No. S7-09-20

Dear SEC:

In summary:

1. **Great job!** This proposal should go forward with only a few minor changes.

[1] All opinions are strictly my own and do not necessarily represent those of Georgetown University or anyone else. Over the years I have served as a Visiting Academic Fellow at the NASD (later part of FINRA), served on the boards of the EDGX and EDGA stock exchanges, served as Chair of the Nasdaq Economic Advisory Board, and performed consulting work for brokerage firms, stock exchanges, market makers, and law firms. I've also visited over 75 stock and derivative exchanges around the world. As a finance professor, I practice what I preach in terms of diversification and own modest and well-diversified holdings in most public companies, including brokers, asset managers, market makers, and exchanges.

2. The annual reports should also contain total risk (standard deviation) and correlation measures, as these are extremely important to wise investing.

3. The liquidity risk is far less important than the total risk and correlation measures, and should be relegated to the online portion.

Introduction

I am a finance professor at Georgetown University where I teach investments courses at the undergraduate, MBA, MSF, and Executive levels. The courses I teach include Principles of Investments, Investment Analysis, and Investments and Fixed Income Securities. I am also a Chartered Financial Analyst (CFA) and a Certified Financial Planner (CFP®). In addition, I am an accredited investor and a Life Member of the American Association of Individual Investors (AAII). I think I know a little bit about what investors need to know about their funds in order to make good investment decisions: **Investors need to understand the potential return of a fund, how risky it is, and how correlated it is with their other assets.** Fees and expenses are relevant for anticipating net returns. Likewise, portfolio turnover and unrealized capital gains are important for estimating after-tax returns.

In a repetitive and wordy 645-page proposing release, the SEC is proposing to replace the current tree-killer reports with a layered approach: Fund shareholders will get very short paper reports with the most important information, while additional useful information is available online for us nerds who want more detail.[2]

This is a great step forward and I commend the SEC for its efforts! I particularly like having a separate concise report for each fund. I greatly dislike having to dig through a 100+ page document for an entire fund family to find the important information about a fund I am interested in. Most of the information in these reports is of little interest to most investors and obscures the important information amidst all of the extraneous clutter.

<u>Investors need to know more about the quantitative level of risk.</u>

The proposed annual report really doesn't tell investors how risky their funds are. The qualitative descriptions of risk provide a nice intuitive explanation of what can go wrong, but they provide no guidance as to how likely such outcomes are. The lawyers who write these narratives try to include every possible scenario so the fund doesn't get sued when something bad happens. Many of these are low-probability events. Listing so many low-probability events causes investors eyes to glaze over and make it easier to ignore just how risky a particular investment is.

[2] https://www.sec.gov/rules/proposed/2020/33-10814.pdf

The parades of horribles are similar from fund to fund and provides little useful guidance to an investor for choosing between funds. Nevertheless, funds do differ in their total risk and this needs to be communicated to investors. While diversified equity funds will have total risk similar to their equity benchmarks, many funds operate complex strategies with total levels of risk that cannot be extracted from the qualitative list of bad things that might happen. Investors need clearly disclosed quantitative measures of risk that are comparable from fund to fund.

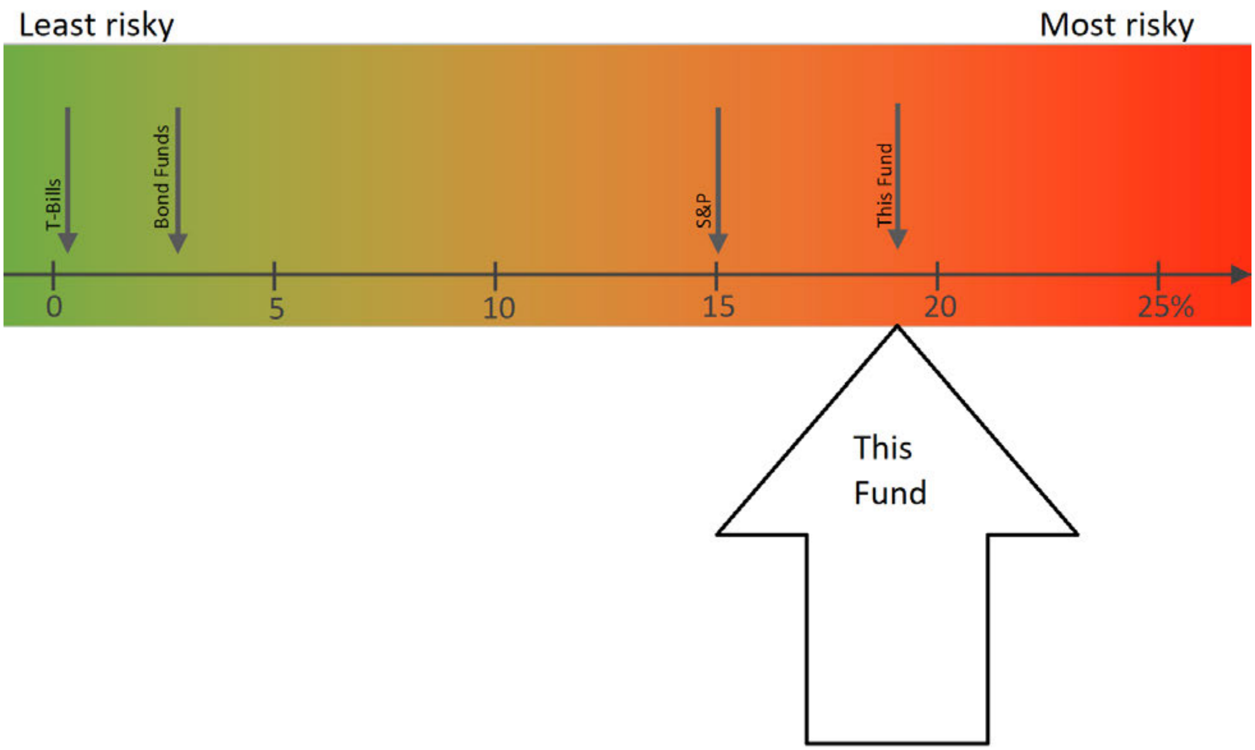
The key statistics should contain information about standard deviation.

The basic lesson of modern finance is the importance of risk measurement. One of the most common, but not the only, risk measurement statistics is the standard deviation of returns for the fund.[3] This is the standard measure of risk in virtually every investments textbook. The annual and semi-annual shareholder reports should be required to include the historical standard deviation for the fund and its benchmark. Investors should be able to see how much risk their fund has taken on over the last 1, 5, and 10 year periods and how it compares with the benchmark's standard deviation.

Such quantitative measurement of risk is a useful offset to the natural tendency for investors to focus solely on past returns. Investors who fall into the trap of looking at past returns need to see what kind of risk the fund took on in order to make those returns. Presenting quantitative risk measures in close proximity to the return measures forces investors to also think about risk. This is one antidote to the regrettable tendency of investors to focus too much past returns.

Since many can comprehend a graphical representation better than numbers, one embodiment could demonstrate the risk of the fund on a risk spectrum that shows where the standard deviation of a fund lies relative to other funds:

[3] For a brief refresher on standard deviation, see https://investinganswers.com/dictionary/s/standard-deviation#:~:text=Standard%20deviation%20is%20a%20measure%20of%20the%20risk%20that%20an,the%20riskier%20the%20investment%20is..



<u>Fixed-income funds differ substantially in their total risk!</u>

Unfortunately, many investors (and many robo advisers) treat bonds as a homogenous asset class in their asset allocation. The reality is that fixed-income funds differ dramatically in the amount of risk they bear. Funds that hold very short-term Treasury securities have very low risk while funds holding long-dated Treasuries have much higher risk. Many fixed income products contain exotic securities whose risk characteristics are not clear at all to fund investors.

The sample report rightly includes the **effective duration** for fixed income funds. This is one of the most essential risk measures for fixed income portfolios and **should be required for all fixed-income funds**. Essentially, the effective duration demonstrates the impact of changes in the general level of interest rates on the value of the fund. Unfortunately, many retail investors do not understand this important concept. By including it as an important statistic, many of them will be motivated to learn more about what duration is and why it is so important.

However, there is more to fixed income risk than duration. Fixed income portfolios may also contain credit risk, currency risk, liquidity risk, as well as risks associated with the embedded derivatives in many fixed income products. Including standard deviation of returns in the shareholder reports will alert them to how risky the fund has been in the past and how it compares with other funds.

Correlation with major asset class proxies is essential.

Another basic lesson of modern investments is the value of diversification. Investors who add some risky assets that are less correlated with their existing portfolios may actually lower the total risk of their portfolios, even if the added assets are riskier than the existing assets.[4] This is one of the reasons why sophisticated institutional investors have invested billions in so-called “alternative” assets because of their low correlations with traditional stocks and bonds. On the other hand, adding assets that are highly correlated with the existing portfolio provides very little diversification benefit.

Investors need to know how correlated a particular fund is with other major asset classes. This can be easily displayed in a tiny table:

Correlation of Monthly Returns of XYZ Fund with Returns of Major Indices Last 60 months or since inception				
	S&P500 Index	Russel 2000 Index	EAFE	Bloomberg Barclay Aggregate US Bond Index
XYZ Equity Fund Correlation	.90	.80	.60	.10

Expenses should also include trading costs.

The proposed reports require fund expenses to be displayed in a variety of ways. This is good and should be retained. However, the total expense ratio does not include brokerage fees and trading expenses. These should also be included, either as part of total expenses or as a separate item in the statistics section.

Turnover is important for estimating costs and tax expenses.

Portfolio turnover is an extremely useful statistic and is rightfully required. It is useful for anticipating future trading costs as well as tax exposure. This should be retained.

[4] For a refresher on correlation, see https://www.investopedia.com/articles/financial-advisors/022516/4-reasons-why-market-correlation-matters.asp

Unrealized capital gains are important considerations for taxable investors and should be included.

Funds that have large amounts of unrealized capital gains can provide a tax bomb for taxable investors. An investor buying into such a fund runs the risk that the fund will sell the appreciated assets and distribute the capital gains. The investor is thus forced to pay taxes on the distribution, even though the distribution was only giving money back to the investor. For this reason, unrealized capital gains per share are a very important statistic that should be included in annual and semi-annual reports. Unsophisticated investors who see this item as one of the required items in the annual report will be alerted that this is an important item, giving them the desire to learn more about it.

The liquidity risk section is just boilerplate and will not provide useful information most of the time.

Liquidity risk is but one of many risk factors. As funds are required to maintain a certain level of liquidity, this section will be routine boilerplate that is routinely ignored by investors. It will not change much from year to year or from fund to fund, and most investors will ignore it.

The liquidity risk section can be moved online. This will create more room on the paper annual and semi-annual report for the munch-more-important risk and correlation measures.

Paper delivery is important.

While electronic delivery is theoretically more cost-effective than paper delivery, the problem is that our email boxes are overflowing with clutter. Important information is easily overlooked, and shareholder engagement is reduced. Note how retail shareholder participation in corporate votes has fallen after notice and access was introduced.[5] I support the requirement that paper delivery be the default unless shareholders explicitly request electronic delivery.

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Respectfully submitted,

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Georgetown University

[5] http://www.shareholderforum.com/e-mtg/Library/20101200_ConferenceBoard.pdf