May 20, 2004

Jonathan G. Katz, Esq.
Secretary
Securities & Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-0609

Re: Public Comment No. S7-12-04; Comments of The Rankings Service (TRS) on the SEC's Proposed New Rules Regarding Manager Identification and Disclosure

Dear Mr. Katz:

On behalf of **THE RANKINGS SERVICE (TRS**) I am pleased to have the opportunity to comment on the proposed new rules regarding disclosure of the identity and various attributes of individual portfolio managers of mutual funds.

The U.S. capital markets perhaps did not need a major mutual fund scandal to demonstrate the simple point: fund companies and their fiduciaries are only as good, or mediocre, or venal – as the individual portfolio managers whose investment decisions and behavior profoundly influence the performance of the funds themselves.

TRS commends the SEC for its extensive and thoughtful proposed rules designed to shine new light on portfolio managers. We should hasten to disclose that such proposals are preaching to the converted, insofar as TRS has developed an entire template of data and analytics based expressly on examining the performance of portfolio managers rather than funds (please see below).

[The Rankings Service (TRS) is an independent research service which presents data and analytics based on its proprietary method for analyzing the performance of investment managers. Instead of tracking a fund's historical performance, TRS tracks the career performance records of the *individual portfolio managers* themselves. Instead of rating *funds* according to complex arrays of subjective and objective criteria, TRS *ranks the managers* according to the simple and objective criterion of each manager's career performance record.

Identifying, tracking and monitoring the managers' historical performance (currently tracking managers spanning more than 10,000 funds), enables TRS to cover the fund investment universe one manager at a time. Doing so provides broad coverage and granular detail of the most widely held investment instruments: mutual funds. This method also discloses various discrepancies between and among *fund reputation, marketing, advertising, various ratings, and historical performance* and the *performance of the manager who is presently running the fund*. In short, in an individual performance-based business in which no one has been keeping the individual statistics, TRS presents unique "batting averages" of the "players" for the first time. Past performance is not predictive of future performance. TRS provides individual manager career performance in the belief that career numbers may discern stock-picking talent or skill.]

Our essential comment on the proposals is to approve and salute all SEC efforts to spotlight and recognize the crucial role played by portfolio managers in the world of mutual funds. If anything, TRS believes that these proposals are just a start, and that further focus on portfolio managers might ultimately lead to *individual portfolio manager registration*. (Does it make sense that barbers, beauticians, architects, opticians, accountants, doctors, lawyers, and all manner of skilled artisans and professionals are subject to extensive and ongoing registration, but the individuals with their hands on our life savings are not required to register anywhere? Or that Sarbanes-Oxley requires strict new accountability, certifications and criminal liability on CEO's and CFO's of public corporations, attributing responsibility for their entire corporations'accounting; yet the 95 million American mutual fund investors, and their nearly $8 trillion invested, doesn't give rise even to disclosure of *portfolio managers' identities, much less their responsibility*?).

Other ultimate policy reform destinations might include:

- Full disclosure of the amounts of portfolio manager compensation, and the nature (salary, bonus, incentive compensation and the basis of said incentive compensation), and an ability for investors to cross-reference that compensation to manager and fund performance metrics;

- Uniform and comprehensive SEC regulation of mutual funds, separate accounts, and hedge funds, and the portfolio managers thereof, on an equal and non-discriminatory basis. [These three categories comprise the real-world menu of investment options for U.S. investors: why should two classes be regulated, one not; and for example: the same manager managing one portfolio that is regulated and one that is not?];

- An outright ban on mutual fund managers simultaneously managing hedge funds and/or separate accounts -- due to the conflicts of interest inherent in the differentials in incentives and compensation in the different entities – and the lack of transparency to investors in the discrete funds as to what the manager is doing with respect to the other funds managed, and

- Strict annual disclosure of all securities held (bought and sold during the previous quarter) by individual portfolio managers in *all funds that they manage, and disclosed to all investors in all funds managed by that manager.*

But rather than to leave it at this simple endorsement of current proposals (and a wistful gaze at a future that may never be), we appreciate this opportunity to make two related points regarding areas where perhaps more needs to be done, and a different tack taken, to provide the basis for investors and advisors to make the most informed judgments and decisions about investing in mutual funds.

1. **Why elevate the *Procedural/Evidentiary Approach to Disclosing Interests* above, and to the exclusion of, *Substantive Focus on Manager Value-added and Investment Results?***

We take close note of a statement contained in the SEC's instant request for public comments (S7-12-04):

"Our current proposals, however, require disclosure regarding portfolio managers *not in order to help investors assess the portfolio manager's contribution to the fund's investment success*, but rather to shed light on the manager's alignment with investors' interests and on potential conflicts of interest." [My italics added].

The above statement concisely telescopes in on the SEC's purposes in these proposed regulations: i.e. the disclosure of conflicts of interest and the elucidation of certain aspects pertaining to alignment of interests. This focus is on establishing procedures and providing evidence on which basis observers can then draw certain inferences and conclusions.

These matters of transparency and disclosure are important, and are not to be minimized. Yet, we at TRS see *the very mission expressly eschewed* by the SEC in the above-referenced quotation to be one of fundamental concern to investors, advisors and fiduciaries – and one to which we have devoted substantial attention. Indeed, in addition to, or apart from, knowing whether portfolio managers interests and compensation, etc. are aligned with investors' interests, it seems reasonable that said investors would also be most grateful for help "…to assess the portfolio manager's contribution to the fund's investment success."

Indeed, isn't it the active managers' value-added contribution to investment success which is *substantially, or precisely, the service for which the investor is paying* (and paying handsomely)?

Hence TRS' focus expressly on manager performance, and more specifically the extent to which portfolio managers of actively managed mutual funds *do or do not add value in consideration of the active management fees.* This focus – in measuring managers' career performance versus relevant benchmarks, versus each other, and according to multiple measures of risk, return, seasonality, etc. – provides insights that arguably go to the heart of *the substance* of what investors want to know about portfolio managers, as opposed to the *procedural or evidentiary approach* which endeavors to inform the investor regarding actual or potential conflicts of interest, and matters of interest alignment. The latter leaves it to the investor (or advisor or fiduciary) to make judgments based on their own speculations as to the likely impact on behavior of the alignments, or misalignments, of interest. The TRS laser beam into whether managers did, or did not, add value essentially ignores the question of interest alignment and goes directly to the facts, i.e. the actual career investment performance of the portfolio manager. On this construct, one might imagine a situation of abundant or even egregious misalignment in, or conflicts of, interest, but delivery of outstanding value-added investment performance by the portfolio manager.

This is not to condone conflicts of interest; rather only to posit that some investors might prefer outstanding investment results from a manager whose interests might not be perfectly aligned versus dismal investment results from a manager whose interests *are* perfectly aligned. They would presumably be particularly disappointed at desultory performance from managers with blatant conflicts of interest. But the assumption that neatly aligned interests correlates with investment success – or conflicting interests with investment failure – is at least debatable and at best subject to further study. Moreover, to cite just one random example, this precept is belied by the experience of venture capitalists whose interests are typically painstakingly at one with their investee companies, yet consistently 7 or 8 out of ten of them fail.

The point here is not to argue that it is less than desirable to require disclosure, or even ban, various forms of conflicts of interest. Instead, this is to suggest that making interest alignment the paramount, or only, object of attention misses the mark, and may tend to elevate this set of procedural and evidentiary concerns above, or to the exclusion of, investment results.

2. The Paucity of Actionable Investment Information Re: Value-added by Active Managers

Assuming that investment results might also matter, and then trying to discern specifically the value-added contribution of active portfolio managers, this raises the related question: how *does* one ascertain whether their portfolio manager is doing what he or she is paid to do, i.e. add value?

For starters, the answer is elusive in that under current rules and practice there is no regulatory requirement or ready source even to know who these individual active portfolio managers are. Some firms identify on their websites. Some describe manager tenure or reveal educational backgrounds.

Other fund companies point to "teams", and it is also possible to find some biographical information in Funds' "Statements of Additional Information." But by and large, to use a sports analogy, mutual fund management can be characterized as an industry with only team "stats" – and no headlong rush by mutual fund companies to step forward with their own version of individual statistics, much less the fund equivalent of baseball cards of the individual players. Nor does there appear to any publicly disclosed or organized focus on this whole area of individual portfolio manager performance and value-added in the Rule 15-c process by which fund independent directors and trustees acquit their fiduciary duties with respect to advisers' contract renewal and fee approval. (Again here, it would seem logical for fiduciaries to want to know whether the active portfolio managers have, or have not, added value!).

One notes a familiar admonition to investors: "buy the manager, not the fund." Yet there has been no organized mechanism by which to do so. More fundamentally, notwithstanding the extraordinary range, depth, breadth and sweep of data available on mutual funds – much of it for free on the internet -- there is precious little out there which provides the basis for clear, simple, actionable investment information, much less "advice".

Without necessitating a longer recitation here, this also goes to the point that Morningstar, the dominant ratings agency purveying its trademarked "star ratings", and other templates for tracking fund qua fund performance, offer hugely influential "good housekeeping" seals of approval. So overwhelmingly influential are 4 and 5 star ratings that it is estimated that 98% of capital flows, i.e. new purchases of mutual funds, are to 4 and 5 star funds. Yet even the sponsor of these fund ratings acknowledges that the ratings are "an achievement test, not an aptitude test." And upon closer examination, the evidence compiled by Mark Hulbert recently indicated that not only did 4 and 5 star rated funds not outperform 3 star funds on a going-forward basis; but actually the opposite obtained.

The point is not to impugn the valuable data and analytics proffered by Morningstar and other fund ratings services. Rather it is to take note that even the most sophisticated tools available may obscure rather than enlighten with respect to genuine value-added contribution by investment managers, much less even present a ratings template that is of even putative value in making investment decisions on a going forward basis. To the extent that this is the case, today's ubiquitous ratings templates can serve to instill investors with a false sense of the ratings' meaningfulness – assuaged, or super-charged, by extensive advertising, marketing, and branding campaigns based thereupon.

Accordingly, and as a counterpoint to the emphasis of these proposed regulations, perhaps the SEC *should* be encouraging intellectual ferment in generating new research and tools, designed and expressly to ***"…help investors assess the portfolio manager's contribution to the fund's investment success."***

Finally, we take note that the mutual fund scandals' areas of focus to date have ebbed and flowed from late-trading and market-timing, to hidden costs and inadequate disclosure of marketing incentives and fees, to mutual fund cost reduction efforts, and onward perhaps to other realms such as variable annuities, 529 programs, and pension consulting. Surprisingly, neither the regulators nor the public have yet turned bright the spotlight on the entire realm of fund and portfolio manager performance – i.e. what consumers/investors *actually get* in consideration of the funds' elaborate expense ratios.

We respectfully suggest that this whole area of performance – of the funds qua funds and the current portfolio managers of record -- and specifically the proximate causation and connections between active manager actions and value-added contribution to investment results – be included in the next iteration of SEC consideration of the role of individual portfolio managers.

Thank you for this opportunity to comment on proposed rules regarding portfolio manager identification and disclosure. We wish you well on your extensive efforts on this and the many other proposed reforms of mutual fund regulation and practices.

Sincerely,

Burton D. Sheppard
1712 E. 27th Avenue
Spokane, WA 99203

President
Lowell Sheppard Holdings, LLC/
The Rankings Service (TRS)
Budshep22@aol.com