MEMO# 13747

July 17, 2001

ICI LETTER TO SEC CONCERNING FREQUENCY OF MUTUAL FUND PORTFOLIO HOLDINGS DISCLOSURE

[13747] July 17, 2001 TO: ACCOUNTING/TREASURERS COMMITTEE No. 21-01 SMALL FUNDS MEMBERS No. 21-01 RE: ICI LETTER TO SEC CONCERNING FREQUENCY OF MUTUAL FUND PORTFOLIO HOLDINGS DISCLOSURE Earlier today, the Institute filed a letter with the Securities and Exchange Commission's Division of Investment Management providing its views on issues related to the frequency with which mutual funds disclose their portfolio holdings. The letter is intended to assist the staff as it considers these issues in connection with a forthcoming rulemaking proposal designed to improve disclosure in mutual fund shareholder reports. In addition, it responds to several rulemaking petitions calling for the SEC to increase the frequency of mutual fund portfolio holdings disclosure beyond the current requirement of twice a year. The letter and a related Institute press release are attached, and the letter is summarized below. The letter begins by strongly urging the SEC staff to reject suggestions to increase the frequency of mutual fund portfolio holdings disclosure. The letter states that, as a preliminary matter, there is no compelling reason for the SEC to require more frequent disclosure. In this regard, the letter notes that mutual fund shareholders have not indicated that they want more frequent portfolio holdings disclosure and that, to the extent an investor does desire more frequent disclosure, it is widely available. Attached to the letter are the results of an informal Institute survey, which showed that mutual fund complexes disclose some or all of their funds' holdings more frequently than semi-annually. The letter also points out that there is no evidence that more frequent disclosure would help fund shareholders. The letter then asserts that requiring more frequent portfolio holdings disclosure would harm fund shareholders. It explains that a requirement for more frequent disclosure would expand opportunities for speculators and other professional traders to exploit the information in ways that are detrimental to fund shareholders, such as "front running" fund trades and "free riding" on fund research and investment strategies. In support of this theory, it discusses a recent academic study conducted by Professor Russ Wermers of the Department of Finance, Robert H. Smith School of Business, University of Maryland at College Park. The letter notes that the Institute retained Professor Wermers to analyze the potential effects of more frequent portfolio holdings disclosure on mutual fund performance in order to examine in a more 2rigorous fashion the harmful effects of requiring more frequent portfolio holdings disclosure. As discussed in the letter, Professor Wermers' study concludes that, if more frequent portfolio holdings disclosure were required, even with a 60-day lag, abusive activities would become more widespread and would adversely impact fund performance. A copy of the study is included as an attachment to the letter. The letter also emphasizes that

concerns about the adverse effects of requiring more frequent disclosure of fund portfolio holdings on fund shareholders are not just theoretical. In a scan of financial websites on the Internet, the Institute uncovered several examples of services that claim to provide clients with the ability to “piggyback” off of fund research and investment strategies. The letter notes that the gains for those who would exploit the information will come at the direct expense of fund shareholders, a result that would appear to contravene the SEC’s investor protection mandate. A summary of these websites is included as an attachment to the letter. Noting that the aforementioned services also rely in part on disclosures made by institutional investment managers in quarterly reports on Form 13F, the letter recommends that the SEC conduct a review of these reporting requirements to determine what modifications (such as to the frequency of filing such reports) are needed to ensure that 13F reports achieve their intended objectives without promoting activities that negatively impact mutual fund shareholders. Finally, the letter reiterates the Institute’s support for changes that would improve the quality of information about mutual fund portfolio holdings that is provided in shareholder reports, including streamlining the schedule of investments and requiring graphic presentations of portfolio information. Craig S. Tyle General Counsel Attachments Attachment no. 1 (in .pdf format)
