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Opinion: The Tax Threat to Your Mutual Fund

Vanguard Chairman and CEO Bill McNabb sent "an open letter to all mutual fund investors" in the opinion pages of Thursday's Wall Street Journal. His message: fund investors face a clear threat of higher costs, weaker returns, and a bailout tax to salvage other failing financial institutions—all if regulators get their way in imposing new rules on funds or their managers.

In "The Tax Threat to Your Mutual Fund," McNabb, who is also chairman of the Investment Company Institute, warns that regulators who were charged with protecting taxpayers from future bailouts are now pursuing a course that "might place that burden squarely back on Main Street mutual fund investors without any solid evidence that the funds or their managers could bring on another panic."

The reason: the Financial Stability Oversight Council in the U.S. and the multinational Financial Stability Board could declare that funds or their managers are "systemically significant financial institutions" (SIFIs), just like the highly leveraged banks whose failures wreaked financial havoc in the 2008 crisis. Under the Dodd Frank Act, "if one (SIFI) fails, all other SIFIs will be responsible for bailing it out," McNabb writes.

The result: "the 90 million Americans invested in mutual funds for retirement, education or a new home could be forced to once again bail out 'too big to fail' Wall Street firms."

"Investor returns would suffer even absent a bailout," McNabb writes. "Mutual fund companies could be required to hold capital reserves, potentially up to 8% of the fund's assets based on current Dodd-Frank requirements. Such capital requirements would be raised through fees paid by investors. Any capital reserves that are sitting in a mutual fund are not generating returns in the stock or bond markets. According to research from the American Action Forum, capital requirements could trim as much as 25 percent from a mutual fund investor's returns over a lifetime of investing."

This drive for SIFI designation ignores simple facts, McNabb says: "Mutual funds and their managers are not banks. They do not impose risks on financial markets like banks do. They have fundamentally different structures with fundamentally different risk profiles. They are organized and regulated in a way that limits risk to the financial system. Designating a handful of mutual funds as SIFIs will not reduce systemic risk in the markets."

Bill McNabb brings another powerful voice to the chorus protesting regulations that would undermine mutual funds and harm their investors. As he concludes, "Let's not regulate for regulation’s sake. And let’s not go back to the misguided approach of having Main Street bail out Wall Street.”

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