

VIDEO

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ICI Chief Economist Discusses Reports that SEC is Examining Mutual Funds and Financial Stability

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In a September 8, 2014, appearance on CNBC's Nightly Business Report, ICI Chief Economist Brian Reid discusses media reports that the Securities and Exchange Commission (SEC) may be considering new rules for fund disclosure, as well as the need for funds to perform "stress tests."

Transcript

Tyler Mathisen: Stress tests for mutual funds? Well, that is what the SEC apparently is considering, this according to a front-page story in today's Wall Street Journal. The commission, says the paper, is potentially developing reporting requirements and other procedures to determine how mutual and hedge funds would weather dramatic jolts to the financial system, such as a sudden large move in interest rates.

Brian Reid, chief economist at the mutual fund industry's main trade group, the Investment Company Institute, joins us now. Brian, welcome back. Good to have you with us. It seems to me that what the SEC may most be concerned about are derivatives and the leverage that they can bring into either mutual fund portfolios or into exchange-traded funds that are sometimes double- and triple-levered to the benchmark that they are trying to follow. How dangerous is the use of these derivatives and that leverage in the context of a mutual fund?

Brian Reid: Mutual funds and ETFs both have the same sets of rules, and the SEC has had rules in place for many years on limiting that amount of leverage, as you say, in these funds. We don't really know what the SEC is specifically considering, but their focus is on protecting investors and making sure that those investor protections and that the funds operate well and provide financial stability. What we're understanding is, is that they've been looking at these rules for some time.

Susie Gharib: So, you don't know just yet, Brian, what these rules will entail. But from what you do know, these are going to protect investors, but to what extent will there be cost tied to it? With all the new compliance, the stress tests, and all of that sort of stuff, will there be new fees and new costs to individual investors, and how might these changes also impact

performance of the mutual funds?

Brian Reid: It's hard to know what the rules are that they are considering. One of the things that derivatives can do that's often overlooked is help reduce risk in funds as well, so the SEC is going to presumably be looking at all of these, the positive features of derivatives, as well as the rules that they have in place and the extent to which they can carve those back or limit those if they believe that they need to be updated. But again, the key part here is the SEC has an open process: they look at the rules; they look at what they're proposing as well as the costs of implementing. And then they have an open process for commenting, so investors, mutual fund advisers, and the ICI can all weigh in and provide input into that process.

Tyler Mathisen: As I understand it, Brian, without getting too Washington insider here, you and the ICI—not you personally, but the ICI—is happier having the Securities and Exchange Commission take the lead on this process rather than the FSOC, the Financial Stability Oversight Council, or, say, the Fed, which comes basically more out of a banking heritage. Do I have that correct?

Brian Reid: Yes, we believe that the SEC is the right regulator to be looking at this. They have a 75-year history of effectively regulating mutual funds and fund advisers, and we believe that they have the expertise and the understanding of funds, and this is where it belongs. Financial regulators have been looking at ways to make sure that the rules are providing financial stability, and we believe that this is just part of that overall review. And we believe that the SEC is the right place to be doing that.

Susie Gharib: You're thinking that pretty much this is a good thing for individual investors, but are there any unintended consequences that could come out of these new rules?

Brian Reid: Well, it's hard to know, like I said. We don't know what the rules are. I think we'll have a better idea once the SEC proposes something and that'll allow us to look in-depth at what they're proposing to see if there are any negative effects and if there are more effective or cost-effective ways to actually address the concerns that they have and to gather the information that they believe that they need.

Tyler Mathisen: Brian Reid is the chief economist at the Investment Company Institute. Brian, thank you.

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