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ICI Chief Economist on How Regulations Affect American Investors

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In a September 9, 2014, appearance on Fox Business Network's The Willis Report, ICI Chief Economist Brian Reid and American Action Forum President Douglas Holtz-Eakin discuss the potential impact of new financial regulations on mutual fund investors, amid media reports that the Securities and Exchange Commission (SEC) is considering new rules regarding mutual funds and financial stability.

Transcript

Gerri Willis: Well, the federal government could be putting your retirement savings at risk. Regulators are becoming, well, overzealous in finding threats to our financial system and they are looking straight at your mutual fund. In fact, this government overreach could lead to you losing tens of thousands of dollars, maybe more.

Here to explain, Douglas Holtz-Eakin, president of the American Action Forum, and Brian Reid, the chief economist at the Investment Company Institute, the trade group that represents the mutual fund industry.

You know, guys, it's been almost six years to the day that Lehman Brothers filed bankruptcy, and the government ever since has been trying to find a way to keep that kind of financial disaster from happening again. Doug, who do they have their sights on now, and what do they want to do?

Douglas Holtz-Eakin: Well, the group in question is the Financial Stability Oversight Council, created by Dodd-Frank, and it has enormous powers to designate a financial institution as "systemically important" and if they do that, they then fall into what is meant to be a much tougher regulatory regime. Specifically, though, they'd end up with capital charges of 8 percent, in a bank-style regulatory setup. This is utterly inappropriate for a mutual fund. It makes no sense whatsoever, and it will cost people a lot of money.

Gerri Willis: All right, well, let's break that down for just a second, because what you said is a mouthful and it's very, very complicated. Brian, I'll turn to you. Now, you know, big banks—you look at JPMorgan Chase, you look at Citi, you look at Goldman Sachs, the big investment banks, the big trading houses, those companies—can create a lot of mayhem and they sure have in the past. What about the mutual fund industry? Is your industry, are you guys going to create just a nightmare for the economy? What are the chances?

Brian Reid: There has never been a case in their 75-year history where mutual funds or mutual fund investors created the kinds of financial market problems that Dodd-Frank was intended to address. And that is where our concern is here—to take rules that were put in place for the banking industry and apply those to mutual funds would be detrimental, and it would be detrimental to the economy, as well. The flow of capital that is coming from mutual fund investors to finance American businesses would slow considerably and slow the economy down.

Gerri Willis: You just stop that up like turning off a faucet. Doug, to you, you've actually studied this, and I'm trying to simplify this because, frankly, it's not that complicated. Basically, a bunch of regulators in Washington have decided they've got to put some wrist cuffs on the mutual fund industry or they're close to doing it; they want to put in place what essentially would be capital requirements that would hamstring this industry, because it doesn't operate like banks. How is the structure of this business different from a Goldman Sachs, different from a Citibank?

Douglas Holtz-Eakin: I can give you a very simple example of how different it is. Lehman's asset manager is still in business. Lehman Brothers went away, but the asset manager is still around. Why? Because if you look at a mutual fund, it takes your money, and it invests it in some stocks, say. That means that there's always something backing that mutual fund. They can sell the stock, give you your money back. You're never going to get into a problem.

Gerri Willis: And the last time I looked, it's me [the investor] taking the losses. You know what I mean? It flows right through to me. I guess the fear, Brian, and here's what I'm hearing, you tell me if I'm right, the fear the government has is that every American is going to pull all of their dough out of the market at the same time, and, you know, what's going to happen? What do you respond to that? You guys don't have control over that, obviously, but that's what they think is going to happen.

Brian Reid: Well, it's never happened, first of all. That's just not the way funds operate or investors operate. When I put my money in a mutual fund, I'm investing for the long-term. I'm investing for my retirement, I'm investing for my kid's education, and we find that this money and their investors are really stable. They're providing a base of support, actually, for the capital markets and it makes the capital markets more stable. It's ridiculous to try to…

Gerri Willis: All right, here's the test, my friend. What happened in 2007, 2008—what a nightmare, right? People did not want to be in the markets, so did everybody pull all their money out of mutual funds?

Brian Reid: No. That's the answer. We found the outflows—the money that came out of stock funds—accounted for a couple of percentage points of the overall assets. And the vast majority of money that was in the stock market and in stock funds at the beginning of the crisis were there during and after the crisis, as well.

Gerri Willis: You know, Doug, I just don't get it, and I need you to talk to me a little bit about what this ultimately can cost consumers. Because they're telling an industry to have a capital cushion that probably doesn't need it, so where would that money come from? If you run a mutual fund, where would you pull that 8 percent?

Douglas Holtz-Eakin: You have to pull it out of the earnings, there's no other place for that money to come from, and over a long-term investor's life, exactly the kind of person who's in a mutual fund, we're talking about a 25 percent reduction in their returns, so let's say $100,000 for a lifetime investor.

Gerri Willis: Whoa, whoa, repeat that.

Douglas Holtz-Eakin: Those are the people who are in this.

Gerri Willis: Repeat that, repeat that. So, you're telling me that I'm going to earn $100,000 less over the lifetime of investing because of some rule from some obscure government committee?

Douglas Holtz-Eakin: 100 percent, that is exactly what is at risk here. And remember, that obscure rule is just a disguised tax. It's forcing you to do something different, you might as well be writing the check to the federal government, and it's a big check.

Gerri Willis: Brian, quickly, and I know this isn't a fast answer. But what should be done? Should the government do anything to try to prevent another 2007 or 2008?

Brian Reid: You know, they've done that. One of the clear sources was leverage and trying to keep the amount of debt manageable. Mutual funds don't issue debt. When I invest in a fund, I'm investing directly in that stock or in that bond. Mutual funds provide stability, and I think that is what is important to keep in mind. Regulators have dealt with it. Let's not overreach here.

Gerri Willis: Bottom line. If this happens, investors like me and you are going to be paying double the fees on our mutual funds. I got to tell you, I pay enough fees already; I don't need more fees, especially ones instituted by the government. Doug and Brian, thank you.

Douglas Holtz-Eakin: Thank you.

Brian Reid: Thank you.

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- ICI Statement on SEC Role in Financial Stability
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