INVESTMENT COMPANY INSTITUTE®

Paul Schott Stevens, PRESIDENT AND CEO

1401 H Street, NW, Washington, DC 20005-2148, USA
202/326-5800 www.ici.org

202/326-5901 FAX: 202/326-5806
paul.stevens@ici.org

March 14, 2019

The Honorable Chuck Grassley
Chairman, Committee on Finance
United States Senate
Washington, DC 20510

The Honorable Richard Neal
Chairman, Committee on Ways and Means
United States House of Representatives
Washington, DC 20515

The Honorable Ron Wyden
Ranking Member, Committee on Finance
United States Senate
Washington, DC 20510

The Honorable Kevin Brady
Ranking Member, Committee on Ways and Means
United States House of Representatives
Washington, DC 20515

Dear Chairman Grassley, Chairman Neal, Ranking Member Wyden, and Ranking Member Brady:

On behalf of 100 million shareholders who invest in US mutual funds to save for their and their children's futures, I am writing to convey the Investment Company Institute's (ICI)[*] strong objection to the Wall Street Tax Act of 2019, introduced by Senator Brian Schatz (D-HI) and Representative Peter DeFazio (D-OR) (S. 647 and H.R. 1516, respectively), to impose a financial transaction tax (FTT). While targeted at Wall Street, the burden of the tax would fall squarely on American workers, retirees, and businesses. The proposed FTT would substantially harm US financial markets, which are the broadest and deepest in the world. It would make it more expensive for businesses to invest and increase borrowing costs for the US Treasury, state and local governments, and homeowners. And, it would affect all investors—reducing investment returns for anyone saving for retirement, for college, or to buy a home.

An FTT would affect the 100 million mutual fund shareholders in two ways. Mutual funds buy and sell securities at the portfolio level to invest cash from shareholder purchases, obtain cash to meet shareholder redemptions, and to adjust fund portfolios. While it is true that the mutual fund would "pay" the tax on its portfolio trades, the full cost of the tax would fall on the fund's shareholders—who are the fund's sole owners and bear all of its costs. An FTT would increase the cost of these necessary transactions and reduce the rate of return earned by the fund. In addition, when shareholders withdraw funds the tax would directly apply to the redemption of mutual fund shares. Significantly, the tax will harm retail investors when they periodically rebalance their portfolios, sell fund shares to make purchases or pay taxes, take distributions in retirement, and roll-over a 401(k) when they change jobs.

[*] The Investment Company Institute (ICI) is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's members manage total assets of US$21.9 trillion in the United States, serving more than 100 million US shareholders, and US$6.6 trillion in assets in other jurisdictions. ICI carries out its international work through ICI Global, with offices in London, Hong Kong, and Washington, DC.

Forty-four million US households that own mutual funds, IRAs, or defined contribution plan accounts have annual income of less than $100,000 and 67 million have annual income of less than $200,000. These are not wealthy households, and they represent from 58 percent to 89 percent, respectively, of all households that own mutual funds, IRAs, or defined contribution plan accounts. The FTT would represent a substantial burden on these investors.

While a 10-basis point tax may sound "small," it would have a large effect on investment returns. In 2018, the proposed FTT would have reduced the returns of long-term mutual funds by $23 billion, or 14 basis points, the same effect as a 31-percent increase in the average expense ratio for 401(k) plan participants invested in equity mutual funds, and a 60-percent increase for equity index fund investors. Investors saving for retirement have benefitted tremendously from falling expense ratios; this tax would significantly negate the benefit that reduced costs have had on investment returns.

Money market fund investors would fare even worse under the proposed FTT, suffering an estimated $20 billion in additional costs due to the tax, a reduction of 71 basis points in return, which would be a substantial hit given current low interest rates. These likely represent lower-bound estimates of the effect on investment returns, as they reflect only the direct impact of the FTT and do not account for deterioration in liquidity and market quality.

The evidence that FTTs harm financial markets is clear, and the impact of the proposed US tax, which is projected to raise $777 billion over 10 years, would likely be even greater than that of existing FTTs. Empirical research finds that FTTs imposed in other countries have reduced trading volume, impaired liquidity, and distorted price discovery. Unlike most existing FTTs, however, the proposed US tax would not exempt market makers and other liquidity providers, meaning many trades would be taxed twice—once when an intermediary buys shares from an investor and again when another investor later buys the shares from the intermediary. In addition, the base of the tax is much broader than is typical, encompassing not just stocks but also partnership interests, debt, and derivative contracts.

Further, there is no evidence of the purported benefits of an FTT. Most studies have found that FTTs have either no effect on market volatility or increase it. In addition, there will likely be tremendous effort to avoid the tax, reducing the revenue raised by the tax and perhaps increasing, rather than reducing, resources devoted to financial transactions and financial engineering. An FTT could also cause trading to migrate to lower-cost foreign venues.

For all these reasons, we urge you to reject the Wall Street Tax Act of 2019. Thank you for considering our views.

Sincerely,

Paul Stevens

Paul Schott Stevens
President and CEO
Investment Company Institute