



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

**STATEMENT OF PAUL SCHOTT STEVENS
PRESIDENT AND CEO
INVESTMENT COMPANY INSTITUTE
ON THE U.S. SECURITIES AND EXCHANGE COMMISSION'S
APPROPRIATIONS FOR FISCAL YEAR 2015**

**Subcommittee on Financial Services and General Government
Committee on Appropriations
U.S. House of Representatives**

April 1, 2014

The Investment Company Institute¹ appreciates this opportunity to submit testimony to the Subcommittee relating to the Administration's FY 2015 Appropriations request for the Securities and Exchange Commission (SEC). In the past, the Subcommittee has consistently sought to provide adequate resources for the SEC. For the reasons expressed below, we urge it to do so again this year.

Importance of a Well-Funded and Effective Securities Regulator

Registered investment companies (RICs)² and their shareholders have a strong stake in an effective SEC. RICs are one of America's primary savings and investment vehicles for middle-income Americans. All told, an estimated 97.9 million shareholders in 57.7 million U.S. households owned

¹ The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$16.8 trillion and serve more than 90 million shareholders.

² Fund sponsors offer four types of registered investment companies in the U.S.—open-end investment companies (commonly called “mutual funds”), closed-end investment companies, exchange-traded funds (ETFs), and unit investment trusts (UITs).

some type of registered fund in 2013.³ At year-end 2013, total RIC assets were \$17.0 trillion. These funds, and their millions of investors, benefit from an effective SEC.

RICs are an integral part of our economy in another way, as well. In addition to their role as the investment vehicle of choice for millions of Americans, RICs have been important investors in the domestic financial markets for much of the past 20 years, holding a significant portion of the outstanding shares of U.S.-issued stocks, bonds, and money market securities at year-end 2013.⁴ For example, RICs held 29 percent of the outstanding U.S. stock at year-end 2013.⁵ As major participants in the stock, bond, and money markets, RICs and their shareholders benefit from the SEC's ability to provide strong regulatory oversight of these markets.

Fulfilling New Regulatory Mandates Should Not Take Priority Over Core Functions

Congress must remain highly attentive to addressing annual budget deficits and levels of federal indebtedness. Nonetheless, it also must take care not to deprive the SEC of the resources the agency needs to successfully pursue its investor protection and market oversight functions. As the Subcommittee is aware, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) gave the SEC significant new responsibilities, including expanded regulatory authority over derivatives trading, private fund advisers, and municipal advisors. The Jumpstart Our Business Startups Act (JOBS Act), enacted in 2012, further increased demands on the SEC's limited resources.

³ Burham, Kimberly, Michael Bogdan, and Daniel Schrass. 2013. "Ownership of Mutual Funds, Shareholder Sentiment, and Use of the Internet, 2013." *ICI Research Perspective* 19, no. 9 (October). Available at www.ici.org/pdf/per19-09.pdf.

⁴ Investment Company Institute, *2014 Investment Company Fact Book* (54th ed., forthcoming in May 2014). The Fact Book will be available at <http://www.icifactbook.org>.

⁵ *Id.*

In recent testimony, SEC Chair Mary Jo White expressed concern that the significant expansion of the SEC’s responsibilities pursuant to the Dodd-Frank and JOBS Acts “cannot be handled appropriately with the agency’s existing resource levels without undermining the agency’s other core duties... .”⁶ She explained that without sufficient additional resources, the SEC would be unable to “hire the industry experts and other staff needed to oversee and police our areas of responsibility, especially in light of the expanding size and complexity of our overall regulatory space.”⁷

Although ICI is not in a position to comment on specific funding levels, we appreciate and share these important concerns. Fulfilling new regulatory mandates should not come at the risk of impairing the SEC’s pre-existing responsibilities with respect to the fund industry, nor compromising the interests of their millions of mainstream investors. For example, the SEC, in its 2015 budget request, states that its staff “may” recommend that the SEC revive a 2008 rule proposal that would allow certain ETFs to operate without first obtaining an exemptive order. This type of beneficial rulemaking would allow the regulatory structure to keep pace with innovations in the ETF industry, reduce costs for ETF shareholders and sponsors, and ultimately reduce burdens on the SEC staff. This is indicative of the work for which the SEC should be adequately funded.

⁶ Testimony of Mary Jo White, Chair of the U.S. Securities and Exchange Commission, on “Oversight of Financial Stability and Data Security,” before the United States Senate Committee on Banking, Housing, and Urban Affairs (February 6, 2014), available at <http://www.sec.gov/News/Testimony/Detail/Testimony/1370540757488#.UzA-pZ3D8dU>.

⁷ *Id.*

Increasing Importance of the SEC's International Engagement and Perspective in Financial Regulatory Policy Discussions

As outlined in the SEC's 2015 budget request, the SEC is an active participant in international bodies such as the International Organization of Securities Commissions (IOSCO) and the Financial Stability Board (FSB). Given that domestic financial market participants are increasingly affected by international regulatory activities, SEC engagement is more important than ever. The SEC's collaboration with its counterparts can help minimize troubling or costly regulatory differences and promote better market oversight and investor protection. Moreover, as the world's financial regulators, finance ministries, and central banks debate and seek consensus on the standards and principles that will govern the international financial system, the SEC as an expert in capital markets regulation must have a strong and effective voice.

Policy discussions about how to bolster the stability of the financial system and increase its resilience to future shocks provide a compelling example. Since the global financial crisis, U.S. and global regulators and international bodies such as IOSCO and the FSB increasingly have focused on identifying risks to the financial system at large and how to mitigate such risks. The Dodd-Frank Act created the Financial Stability Oversight Council (FSOC)—on which the SEC Chair serves as a voting member—for this purpose. Notwithstanding the SEC's involvement, the membership of both the FSB and FSOC is heavily tilted toward banking regulators. As a result, there is a natural tendency for those members to view the entire financial system through the lens of their "safety and soundness" concerns and their experience with banks and bank regulations. This, in turn, makes it altogether likely that these bodies may advance policy initiatives without sufficient understanding of or due regard for the way in which the capital markets operate and are regulated, or of how financial institutions other than

banks are structured, operated and currently regulated. The voices of expert capital markets and securities regulators such as the SEC need to be amplified so they can provide relevant information and balance to these policy discussions.

In this regard, in discussing critical 2014 initiatives, SEC Chair White recently stated that the SEC will continue to engage in efforts “to ensure that the systemic risks to our interconnected financial systems are identified and addressed – but addressed in a way that takes into account the differences between prudential risks and those that are not. We want to avoid a rigidly uniform regulatory approach solely defined by the safety and soundness standard that may be more appropriate for banking institutions.”⁸ The SEC’s resources need to be adequate to support these important efforts.

As a related matter, one of the ways the SEC intends to carry out its responsibility to monitor risk in the asset management industry is to improve the information it receives from mutual funds, closed-end funds and ETFs.⁹ Division of Investment Management Director Norm Champ recently explained that the SEC staff is undertaking this initiative to “modernize and streamline the information that funds are reporting to the Commission to give us more timely and useful information” and that one of the goals is to “inform [the SEC’s] efforts to monitor risk.”¹⁰

We support efforts by the SEC to improve its ability to identify and monitor risk through its collection and analysis of enhanced fund data. The SEC should undertake this new data collection,

⁸ Mary Jo White, Chair, Securities and Exchange Commission, “Chairman’s Address at SEC Speaks 2014,” February 21, 2014, available at <http://www.sec.gov/News/Speech/Detail/Speech/1370540822127#.UzCBNp3D8dU>.

⁹ The SEC currently collects and is able to analyze very detailed money market fund information provided through the funds’ monthly filings on SEC Form N-MFP.

¹⁰ “Remarks to the 2014 Mutual Funds and Investment Management Conference,” Norm Champ, Director, Securities and Exchange Commission Division of Investment Management (March 17, 2014), available at <http://www.sec.gov/News/Speech/Detail/Speech/1370541168327#.U0Vqnp3D8dU>.

however, in the most reasonable and efficient¹¹ manner possible, and it should remain mindful that the public release of portfolio holdings data raises significant “front running” and “free riding” concerns.¹²

In support of this initiative, the SEC staff should be granted sufficient resources to conduct the appropriate in-depth analysis needed to assure itself that it can measurably improve its ability to identify and monitor risks without imposing undue burdens on funds and exposing fund shareholders to risks such as front running and free riding. In addition, the SEC must have appropriate systems and procedures in place to ensure the confidentiality and security of such information before requesting it from the fund industry.

The Need for an Efficient and Expert Regulator

No matter what level of funding ultimately is authorized, the SEC must utilize the resources it receives to their maximum effect. In this regard, the SEC deserves credit for its recent efforts to develop, improve, and increase the use of the agency’s economic research and analytical capabilities, in particular through the enhancement of the Division of Economic and Risk Analysis (DERA). For

¹¹ This includes avoiding duplicative requests. Many firms that sponsor or advise mutual funds will be obligated to provide data not only under SEC rules but also under rules of other regulators both domestically and abroad. *See, e.g.*, SEC Form N-SAR; SEC Form N-MFP; SEC Form PF; CFTC Form CPO-PQR; Article 24 of Directive 2011/61/EU and Articles 110-111 and Annex IV of Commission Delegated Regulation (EU) No 231/2013.

¹² Current portfolio holdings disclosure rules strike a careful and appropriate balance between the public’s need for information and the industry’s need to protect its intellectual property, requiring holdings to be publicly disclosed quarterly on a 60-day lag. While more frequent portfolio holdings information may be useful for regulatory purposes, there is no compelling investor protection interest in increasing the frequency or reducing the lag with respect to public disclosure. In fact, doing so would merely expand opportunities for speculators and other professional traders to exploit the information in ways that would be detrimental to fund shareholders, particularly through “front running” fund trades (i.e., trading by others in the market ahead of large trades by funds based on information gleaned from fund filings, thereby adversely affecting the prices of securities the funds wish to buy or sell) and “free riding” off the fund’s investment research (i.e., expropriating the research and investment strategies paid for by fund shareholders by duplicating the investment strategies of funds for free).

example, in 2012, DERA and the Office of the General Counsel circulated to the SEC's rulemaking divisions and offices written guidance on how the staff should approach economic analysis. That guidance should help bring additional focus, rigor, and consistency to the agency's consideration of the economic consequences of its rulemaking activity. DERA also has further developed its ability to create its own analyses, which have enriched the SEC's consideration of money market fund reform.¹³ This type of analysis and technical advice provides useful information to build the public record on important issues before the SEC and helps guide sound policy decisions.

DERA and other SEC divisions, notably the Division of Investment Management, also have made progress in hiring staff with specialized expertise and real world experience. These staff should help the SEC better inform itself about its regulated industry and market, as well as the economic consequences of its regulations. Funding levels should support the continuation of these types of activities and improvements.¹⁴

Conclusion

Congress must assure that the SEC has resources sufficient to fulfill its mission of protecting the nation's investors, including the nearly 98 million investors who own mutual funds and other RICs.

¹³ See, e.g., DERA's March 2014 analyses of data and academic literature related to money market fund reform, covered in four separate memoranda, which examine (i) the spread between same-day buy and sell transaction prices for certain corporate bonds from Jan. 2, 2008 to Jan. 31, 2009, (ii) the extent of government money market fund exposure to non-government securities, (iii) academic literature reviewing recent evidence on the availability of "safe assets" in the U.S. and global economies, and (iv) the extent various types of money market funds are holding in their portfolios guarantees and demand features from a single institution, available at <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370541253716#.U0alaZ3D8dX>.

¹⁴ The SEC's FY 2015 budget request identifies "[h]iring additional staff experts to enhance the agency's oversight of the rapidly changing markets and increased regulatory responsibilities" as a key priority.

These investors deserve the benefits of an SEC that can soundly, effectively, and efficiently regulate securities offerings, market participants, and the markets themselves.

Accordingly, we urge Congress to provide the appropriations necessary to allow the SEC to appropriately fulfill its mission.

We appreciate your consideration of our views.