INVESTMENT COMPANY INSTITUTE

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By Electronic Delivery

April 22, 2019

Representative Mary E. Flowers
251-E Stratton Office Building
Springfield, IL 62706

Representative Gregory Harris
300 Capital Building
Springfield, IL 62706

Representative Delia C. Ramirez
200-5S Stratton Office Building
Springfield, IL 62706

RE: HB0024 – Financial Transaction Tax Act

Dear Representatives Flowers, Harris, and Ramirez:

The Investment Company Institute[1]—on behalf of shareholders in funds registered under the Investment Company Act of 1940 (the "1940 Act")—urges that the Financial Transaction Tax Act (HB0023)[2] exemption for "securities held in a retirement account or a transaction involving a mutual fund" applies to all 1940 Act-registered funds. This expanded exemption, more specifically, would cover expressly both shares of exchange traded funds (ETFs) and closed-end funds that trade on exchanges and the portfolio trades made by all 1940-Act registered funds. Without this expanded

[1] 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$22.4 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.

[2] The proposed financial transaction tax (FTT) would impose a tax at rate of $1 for each financial transaction for which the underlying asset is an agricultural product, a financial instrument contact, or an options contract. It would apply to transactions engaged on the Chicago Stock Exchange, the Chicago Mercantile Exchange, the Chicago Board of Trade, or the Chicago Board Options Exchange. The tax would be paid by the trading facility or by the purchaser involved in the transaction.

exemption, millions of moderate income Americans saving for retirement, for college, for a home, or for other needs would be harmed.

All 1940 Act Funds Must Be Exempted

1940 Act-registered funds are publicly-offered investment pools that provide individuals with access to a diversified portfolio of stocks, bonds, or other securities that these investors cannot replicate efficiently. These funds include not just mutual funds, but also ETFs, closed-end funds, and unit investment trusts. All funds are subject to strong investor protection regulation that is enforced by the Securities and Exchange Commission (SEC). These features make funds attractive investment vehicles for moderate-income investors.[3]

In 2017, 57.3 million or 45.4% of households owned 1940 Act-registered funds.[4] The typical fund investor is a middle-class American with a median household income of $100,000 for those owning mutual funds and $130,000 for those owning ETFs and modest holdings.[5] American families depend on their fund investments to buy a home, finance a child's education, support aging parents or extended family, and prepare for retirement.[6]

The primary difference between mutual funds and other 1940 Act funds is that mutual funds shares are redeemable on a daily basis at a price that reflects the current market value of the fund's securities; they are not traded on a stock exchange. ETF and closed-end fund shares, in contrast, are listed on a stock exchange or traded on an over-the-counter market.

The financial transaction tax proposal, as currently drafted, would tax investors on the purchase and sale of ETF and closed-end fund shares—even though investors in these 1940 Act registered funds are investing for the same reasons as mutual fund investors. Investors purchasing securities (including fund shares) through retirement accounts also most likely would incur the tax—despite the stated exemption—because no mechanism exists by which an exchange can differentiate between investors making purchases through a retirement account versus a taxable account. Moreover, investors who own 1940 Act registered funds (other than mutual funds) through retirement accounts would bear the tax indirectly to the extent that it is imposed on the funds' portfolio trades.

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[3] Retail investors (i.e., individuals) hold the vast majority (90 percent) of US mutual fund assets. https://www.ici.org/pdf/2018_factbook.pdf, Figure 3.3.

[4] https://www.ici.org/pdf/2018_factbook.pdf, 2017 Facts at a Glance.

[5] The most recent ICI data show median mutual fund assets of $120,000 per household in four accounts. https://www.ici.org/pdf/2018_factbook.pdf, Figure 7.2.

[6] The most recent ICI data show that individuals invest in mutual funds to save for retirement (92 percent), for emergencies (47 percent), and for education (23 percent). https://www.ici.org/pdf/2018_factbook.pdf, Figure 7.2.

Harm to Financial Markets

The Institute also requests careful consideration of the impact of the tax on the functioning of the markets.[7] Proponents of the legislation cite other countries with similar taxes as evidence that there would be no reduction in productivity. Empirical research, however, finds that similar taxes imposed in other countries shave reduced trading volume, impaired liquidity and distorted price discovery.

Further, there is no evidence of the purported benefits of similar taxes. Most studies have found that these taxes 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 raise by the tax and perhaps increasing, rather than reducing, the resources devoted to financial engineering. This tax could also cause trading to migrate to lower-cost trading venues outside of Illinois.

Recommendation

The Institute strongly recommends that the financial transaction tax must ***not*** be extended to1940 Act-registered funds. Specifically, the proposal must be clarified to exempt:

1) The purchase or sale of all 1940 Act registered funds (including exchange-traded funds (ETFs) and closed-end funds) on the covered exchanges; and
2) Transactions entered into by all 1940 Act registered funds (portfolio trading)

Application of an FTT to these funds would be borne by their investors—average Americans saving for their long-term needs.

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The Institute appreciates your consideration of our concerns. Please do not hesitate to contact the undersigned at (202) 326-5826 if you have any questions regarding this letter or would like any additional information regarding the organization, operation, or taxation of investment companies and/or their shareholders.

Sincerely,

Katie Sunderland

Katie Sunderland
Assistant General Counsel – Tax Law

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[7] *See* https://www.ici.org/ftt.