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Regulated Funds: Supporting the Economy During the COVID-19 Crisis

BY PAUL SCHOTT STEVENS

On April 15, the secretariat of the Financial Stability Board (FSB) hosted a conference call with more than a dozen global financial trade associations, including the Investment Company Institute, to gather their insights and experiences from the COVID-19 crisis. I had the opportunity to share some of our findings and observations about the response of fund investors to recent developments in financial markets, and the picture that has emerged to date is reassuring.

At the outset of the pandemic, businesses and investors of all kinds raced for liquidity and safe-haven assets, and trading tightened in various markets. But the extraordinary actions taken by the Federal Reserve, Treasury, the Securities and Exchange Commission, and Congress helped relieve pressure and ensure orderly functioning of US financial markets.

Regulated Funds Have Experienced Modest Outflows to Date

So how have fund shareholders responded?

From the data that ICI has collected over the nine-week period from the peak of the US stock market on February 12 through April 15, I could report that fund outflows were small to moderate as a percentage of funds' total assets, contrary to the FSB's oft-stated concerns about liquidity risks from "runs" on open-end funds. This was the case despite a "stress test" of remarkable proportions, including a period of extraordinary volatility and the fastest stock market decline in US history.

Among our findings over this period:

- » Redemptions from equity funds have been negligible—totaling only 0.3 percent of the assets those funds held at the end of January 2020.
- » Redemptions from bond funds were larger but totaled some 5.0 percent of those funds' January assets.
- » Looking at specific asset classes, taxable bond funds accounted for the largest portion of these redemptions, but total redemptions represented only about 0.6 percent of this market and less than 0.6 percent of the trading volume in taxable bonds.
- » Tax-exempt bond funds—those invested in municipal bonds—experienced sizable outflows, but those outflows represented only 1.4 percent of that market and 5.0 percent of trading volume in municipal bonds.

- » Assets in government money market funds, in contrast, jumped by \$1 trillion, reflecting the demands of all investors for the safety and liquidity available from short-term US government securities. Those inflows far exceeded the \$138 billion outflow from money market funds that invest primarily in commercial paper and certificate of deposits.
- » US exchange-traded funds (ETFs) experienced elevated levels of secondary-market trading—buying and selling of ETF shares—as investors used these funds to adjust their exposures rapidly and efficiently. But redemptions from bond ETFs—which can lead to trading in ETFs’ underlying securities—were modest, while equity ETFs saw net creations. Thus, ETF trading had the effect of relieving pressure on the underlying markets and promoted price discovery.
- » From March 2 to April 15, bank loan funds saw outflows of an estimated 9 percent of their February assets, about the same as they experienced during concerns about the Fed’s tightening in December 2018. These most recent outflows were just 0.6 percent of outstanding leveraged loans as of February.
- » From March 2 to April 15, emerging market equity and bond funds saw outflows of an estimated 2 percent of their February assets.
- » Finally, our members advise us that they have not seen a sharp reaction to the market downturn from US retirement savers, who represent a significant portion of fund investors—a response consistent with that during the global financial crisis of 2007–2009.

Implications for Financial Stability

Why do these data and experience matter? Since the 2007–2009 financial crisis, regulators have asserted repeatedly that the growth of nonbank financial intermediaries, particularly open-end funds, poses as-yet unaddressed risks to financial stability. And as the FSB monitors the impact of the COVID-19 pandemic, it has once again identified investment funds as a top potential source of liquidity risk.

But what we have seen to date is consistent with what we have seen at other times of great market stress. Today’s fund investors are behaving as they have in such periods over the past 75 years, staying the course and remaining invested in the markets. Mutual funds have not been a source of instability, and the industry has continued to fulfill its role in financing the real economy.

To be sure, we will continue to track developments in the weeks and months ahead. As the crisis continues to unfold, we hope to have ongoing opportunities to contribute our data and perspective to help the FSB and other financial regulators around the globe form appropriate policy responses to our experience during the COVID-19 pandemic.

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