

ICI VIEWPOINTS

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The Wall Street Journal's Dangerous Disservice to Investors

By Mike McNamee

For 75 years, mutual funds have successfully met their regulatory obligation to fulfill redemption requests within seven days, meeting investor demands and delivering on their investment objectives through good markets and bad.

Yet the *Wall Street Journal* seems determined to ignore this established history and the circumstances surrounding it. It has created a liquidity “measure” of its own devising—a test that no regulator has endorsed and no informed market participant would credit. The newspaper uses its self-invented process to imply that bond mutual funds are “pushing the limits” of Securities and Exchange Commission (SEC) guidelines governing fund liquidity.

Let's look at the facts.

Under the Investment Company Act of 1940, a fund has up to seven days to pay proceeds to investors who redeem shares (although in practice investors usually are paid within one or two business days). Because of this requirement, the SEC has issued guidance that at least 85 percent of a fund's portfolio must be invested in “liquid assets”—assets that can be “sold or disposed of in the ordinary course of business within seven days at approximately the value at which the mutual fund has valued the investment.”

The SEC has never required a simple, mechanical test to determine a security's liquidity. Attempting to do so by comparing a fund's holdings of a particular security to the average daily trading volume in that security—as the *Journal* does—fails to capture multiple factors that are key to determining liquidity. These include characteristics of the issuer and the security, trading characteristics (such as bid-ask spreads, trading volumes, trading frequency, depth of the secondary market for the asset, market impact, and information from pricing vendors), and market conditions.

Indeed, within the *Journal's* own story, fund companies directly refuted the reporters' assertions that certain holdings were illiquid, citing real-life case studies. One example provided by a fund detailed the sale of \$96 million worth of Ford Motor Co. bonds within five days, contrary to the *Journal's* calculation that liquidating the position would take 65 days.

Liquidity management is a constant area of focus for fund managers, traders, risk managers, legal and compliance personnel, senior management, and fund boards. Within the existing legal and regulatory framework, a fund manager's practice of liquidity management is fund-specific—that is, each fund has its own characteristics, investment objectives, policies, strategies, portfolio holdings, potential obligations, historical fund flows, and investor base. Despite what the *Journal* would like to believe, there is no one-size-fits-all approach.

The *Journal* compounds its irresponsible use of an incomplete liquidity test by adopting the false charge that fund investors “move in herds.” That's a claim that ICI has thoroughly and repeatedly disproved, with data. History demonstrates that bond and stock fund investors tend to focus on long-term financial goals, such as retirement. Indeed, 53 percent of those funds' assets are held in retirement accounts. The result is that bond and stock fund investors don't redeem en masse in down markets. The largest monthly redemptions from bond funds in 31 years was 3.3 percent in October 1987—more of a stroll than a “run.”

Investors' ability to redeem their mutual funds on any business day is one of the core features of these funds and a strong benefit for investors. Funds maintain that feature by comprehensively and continuously managing their liquidity. The *Journal's* implication that funds aren't maintaining adequate liquidity does a grave disservice to the 90 million Americans who depend upon mutual funds to advance their financial goals.

Mike McNamee is ICI's chief public communications officer.

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