

ICI Tells SEC That Increased Portfolio Holdings Disclosure Will Bring Risks, July 2001

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Washington, DC, July 17, 2001 - The Investment Company Institute, the national association of the American mutual fund industry, today provided the U.S. Securities and Exchange Commission (SEC) with information demonstrating that average investors are much more likely to be harmed than helped if all mutual funds are required to reveal their portfolio holdings more than the current, twice-a-year requirement. These risks include front running and free riding.

"Based on the serious potential for harm to fund shareholders, the Institute is hopeful that the staff agrees that it would be a grave error for the Commission to mandate more frequent portfolio holdings disclosure by all funds," ICI General Counsel Craig Tyle wrote in a [letter to Paul Roye](#), director of the SEC's Division of Investment Management. "The risks of harm to fund shareholders far outweigh any potential benefits."

The Institute's letter points to substantial evidence that requiring all funds to disclose their portfolio holdings more frequently is contrary to the best interests of fund shareholders. For example, more frequent disclosure would help professional traders and other opportunists more successfully "front run" a mutual fund manager's trades by helping to identify the stocks the fund is in the process of buying or selling. Similarly, more frequent portfolio holdings information would allow speculators to more accurately "free ride" on a mutual fund manager's proprietary research and investment strategies.

The SEC is considering whether to recommend increasing the frequency of portfolio holdings disclosure as part of an initiative to improve the usefulness of a mutual fund's shareholder reports. The Institute's letter notes that an [Institute survey of its members](#) found that many funds already disclose portfolio holdings information more than twice a year. However, the survey also found that some mutual funds have determined that more frequent disclosure creates an unacceptable risk of facilitating abusive practices that would harm their shareholders. In addition, members responding to the survey reported virtually no demand for more portfolio holdings disclosure from their shareholders. "There is no compelling reason for the Commission to require more frequent disclosure," the Institute wrote.

ICI members have developed their current portfolio holdings disclosure policies and practices with shareholder interests in mind. ICI members "have expressed serious concerns about their ability to protect shareholders' interests if portfolio holdings information is required to be disseminated more frequently," the Institute wrote.

Included in the ICI's letter to the Commission is a [new study](#), commissioned by the Institute, examining the likely impact on funds if they were required to reveal all portfolio holdings more frequently than under current law. The study found that abusive trading activities would become more widespread and would adversely affect fund performance. According to the analysis, "the total return that shareholders receive from mutual fund investments would likely be lower than under the current disclosure standard."

The study, authored by University of Maryland finance professor Russ Wermers, explains how more frequent disclosure could potentially raise fund-trading costs by increasing the risk that outsiders would anticipate fund trades and trade ahead of funds. Such "front running" can increase the price that funds pay to purchase securities and lower the price funds receive when they sell.

The Institute's letter makes it clear that the adverse effects of more frequent disclosure are not just theoretical. "Professional traders and others already exploit information about fund portfolio holdings that is currently available," the Institute wrote, noting that services exist today that market themselves as providing clients with the ability to "piggyback" off fund research and investment strategies. Providers of these services, some of which are identified in an [attachment to the letter](#), acknowledge that they rely largely or entirely on the public disclosures mutual funds are required to make under the federal securities laws. According to the letter, these trading

services "no doubt would welcome more frequent fund portfolio disclosure because it would enhance their ability to take advantage of research and investment acumen that is meant to benefit the fund shareholders who are paying for it."

The trading services that are exploiting mutual fund portfolio disclosures are apparently taking advantage of more than just the information provided in shareholder reports. Most mutual fund managers also list their funds' aggregate holdings on Form 13F, which is provided to the SEC and is available on the SEC's EDGAR system. Professional traders and speculators use this information to facilitate front-running and free-riding practices that hurt fund shareholders. Thus the letter includes a recommendation that the Commission reexamine current 13F reporting requirements to determine what modifications are needed to ensure that 13F reports do not promote activities that negatively impact mutual fund shareholders.

Instead of requiring funds to provide encyclopedic lists of portfolio holdings more frequently, the Institute suggests that the Commission consider changes that will improve the quality of information about fund portfolios presented in shareholder reports. For example, the Institute recommends that the Commission consider requiring shareholder reports to include a streamlined schedule of investments that identifies the fund's 50 largest holdings, or all holdings that exceed one percent of fund assets, along with graphic representations of portfolio information. A complete list of fund holdings could be made available free of charge upon request.

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