



All that's hot in the mutual fund industry

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## Group Offers Solution to Contentious Proposal

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The **Coalition of Mutual Fund Investors** (CMFI) recently suggested in a comment letter to the SEC that the Fund/SERV trading platform, which transmits roughly 90% of all electronic orders to participating firms, be used to update fund firms on shareholder trading each week.

That would eliminate one of the biggest problems that brokerages have with the existing proposal. As it stands, the proposal would require intermediaries to update fund firms with shareholder information each week. Those updates would generally require brokerages to disclose to funds information such as shareholders' tax ID numbers, the amount of each trade they make and the dates of their purchases and redemptions.

Providing those reports would be costly. The SEC estimates that the weekly updates would cost intermediaries a total of \$1 billion.

Niels Holch, executive director of CMFI, says his group's solution could provide firms with investor details on a daily basis and the costs wouldn't come close to the SEC's estimates.

The **National Securities Clearing Corporation** (NSCC), which offers Fund/SERV, is now the only registered clearing agency that provides services to fund firms. It processes transactions between funds and their distributors including banks, brokers and financial planners.

NSCC reviews the trade requests, then forwards them to fund distributors. That firm then confirms its acceptance of the order and NSCC settles the accounts of both parties. The entire process can be completed within a day.

CMFI isn't the only proponent of using a system that's already in place.

At the end of January, the NASD's Omnibus Account Task Force released a report acknowledging that the NSCC platform provides a cost-effective way for intermediaries to disclose transaction information for omnibus account holders.

The SEC originally proposed the 2% redemption fee rule in March as a way to deter market timers.

But over 85% of all fund shares are sold through intermediaries, many of which are in omnibus accounts. So third parties keep customer information and fund firms often don't even receive the names of their ultimate customers.

That lack of transparency creates problems for fund firms since they will be responsible for ensuring they're charging investors appropriately.

But using Fund/SERV to provide funds with the weekly reports instead of intermediaries is by no means the perfect solution, according to one observer.

First, he says, Fund/SERV isn't used universally. Many firms, he says, don't need the NSCC to process their business. And even those that do use Fund/SERV bundle transactions, such as those in 401(k) accounts, into a single trade.

Holch says he's not suggesting that companies not already using the system move their business.

"We're not advocating that everybody use Fund/SERV," he says. "We're just saying it's an answer for people who are already using it. It could be more cost-effective for many of them."

There's also the issue of intermediaries' disclosing customer information to fund firms. Even though there are rules prohibiting the use of that information by fund companies for marketing purposes, many intermediaries are still reluctant to divulge it.

Firms are still very cautious about whom they give customer information to, says Nancy Smith, a consultant with **Mantas**, a technology firm that serves the financial services industry.

"Rules can be broken," she says. "Some people may want to avoid the opportunity for mischief."

That's one reason, says Smith, why automation can provide a greater degree of protection to the investing public. Whenever humans are removed from handling data, accuracy improves and the opportunity for willful abuse diminishes.

Ann Bergin, managing director in charge of distribution services for NSCC parent Depository Trust Clearing Corp. (DTCC), says it makes sense to use an existing infrastructure rather than building from scratch.

"If it's determined by the industry that our Mutual Fund Services should be used to transmit omnibus shareholder information, either on a weekly basis as proposed by the SEC or on a same-day disclosure basis, we will make enhancements to those services as quickly and as cost-effectively as possible," she says.

But she notes that specific objectives have not yet been defined.

"As the industry moves closer to a consensus on the direction to take and we're asked to provide solutions, at that point we'll be able to determine which of our services would best support those objectives. It could be Fund/SERV or Networking, or both," says Bergin.

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