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Today's Issue
Aug. 05, 2004

Large Firms Losing Battle Against Timers

By Tom Leswing

A significant number of big fund firms are still struggling to police market timers who buy shares through omnibus platforms. Of the 50 largest fund groups, 37 recently indicated that they are incapable of stopping timers who trade via omnibus account.

That's according to a new study conducted by the **Coalition for Mutual Fund Investors**, a shareholder advocacy group.

Of the 50 firms evaluated, 32 indicated that they impose redemptions fees in an effort to thwart timers. Of those 32, 28 limit, waive, or exclude their redemption fees when the funds are purchased and sold on omnibus platforms. Another 18 fund groups don't impose redemption fees. Of those, nine say they don't impose the fees because the charges can't be enforced with trades done through omnibus systems.

The study, which gathered information from recent prospectus filings and other public documents, recommends that omnibus platforms provide fund groups with more information on trading activities.

The study likely comes as a shock to many in the industry. Ever since the fund scandal erupted a little less than a year ago, the fund industry has been in overdrive trying to address market timing and late trading. Fund groups have been frantically updating their policies on market timing and regulators have been churning out rules to solve those problems.

The problem is, many broker-dealers and retirement plan service providers use omnibus accounting. It entails batching together investors' trade orders each day. Each individual broker-dealer and plan service provider then submits one big trade to fund firms, rather than smaller, single-trade orders for each shareholder. That means that fund firms don't know the identity of the individual investors who are placing the trades or how long they have owned their shares. The end result, according to the coalition, is that market timing is hard to identify and therefore hard to shut down.

"I was pretty surprised at how wide spread the use of omnibus accounting is and that so many fund firms said that they can't police market timing in omnibus accounts," says Niels Holch, executive director of the coalition. "I was surprised at the depth of the problem."

Many funds' prospectuses outline the problem. Take the prospectus for **American Century**'s **Veedot** fund. It says the firm's "ability to monitor trades that are placed by the individual shareholders of omnibus accounts maintained by financial intermediaries is severely limited because American Century does not have access to the underlying shareholder account information." Prospectuses for funds offered by **ING**, **Janus**, **One Group** and **T. Rowe Price** also point to difficulties with imposing redemption fees through omnibus accounts.

The **Hartford Advisors** funds, which do not impose redemption fees, provide another example. The rationale behind not imposing fees is due to the fact that the "funds cannot always know or reasonably detect excessive trading by investors that enter orders through omnibus accounts," according to the prospectuses.

That does not mean, however, that there are not efforts under way to shed light on trading activity taking place on omnibus platforms. Many see those changes as necessary in stopping timers.

"I'd say it would be very difficult [to do] if there are no changes made," says William Alsover, Jr., chairman of **Centennial Securities** . Alsover was a member of the NASD Omnibus Account Task Force, which has created a variety of recommendations on how omnibus trading can be modified to help thwart market timers.

Among other things, it recommended that omnibus firms provide fund companies with more information on the identities of shareholders or financial advisors. The SEC has incorporated some of those recommendations in a proposed rule that would mandate that all mutual funds impose a redemption fees. Additionally, the proposed rule says that broker-dealers would be required to halt market timing, even if they do provide fund firms with more details on investors' trading activities.

"Just passing on the information to fund companies isn't going to be a safe harbor for broker-dealers," Alsover adds.

At the same time, the coalition is proposing that broker-dealers provide additional trading information. Holch has no specific estimate as to how much the change may cost the broker-dealer industry or fund firms. He maintains that the cost of doing so would be reasonable, because the industry could use existing technology provided by the **National Securities Clearing Corp.**

Those efforts are also supported on Capitol Hill where Senator Peter Fitzgerald (R-Ill.) has introduced a bill that would require omnibus platforms to provide fund firms with enough information to police market timers. The legislation is currently being reviewed by the Senate Banking Committee, according to a spokesman for the Senator. Fitzgerald issued a press release yesterday highlighting the study to trumpet his efforts to reform the mutual fund industry.

Not everyone is convinced, however, that market timing through omnibus accounts is continuing to be a big problem.

"Most of the fund companies are saying that marketing timing is falling off,'' says Gail Weiss, founder of **Gail Weiss & Associates,** which provides software for retirement providers that want to process trades through the NSCC.

When fund firms get large trade orders, they typically contact the broker-dealer that submitted the order to inquire about the identities of the investors submitting the trades. That allows them to assess if the big order is from market timers.

"That is certainly something that is going on today," she says. "And the comments that I get are 'not only is market timing under control, it's virtually eliminated.'"