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Fund Action

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HEADLINE: SEC Taking Aim At Omnibus Accounts

BODY:

The Securities and Exchange Commission is taking a fresh look at whether fund share transactions--now hidden in omnibus trades conducted by brokerage firms--ought to be made transparent on the books of fund companies as a deterrent to a possible new wave of market timing. Most fund shares are traded through omnibus accounts. A change in the status quo could increase disclosure costs and also impact the industry's distribution system.

SEC Chairman Mary Schapiro is speaking out on the matter. Schapiro, in a June 23 letter to the Coalition of Mutual Fund Investors, said the Commission "will now consider whether Rule 22c-2 [which permits the use of omnibus accounts] is ineffective in preventing inappropriate frequent trading, or could be made [to require] more frequent transfer of account information."

Rule 22c-2 was adopted in 2005 to impose a 2% redemption fee on frequent traders to penalize market timing. At that time, the SEC left omnibus trades untouched because it was felt the cost to funds and shareholders of making the trades transparent would outweigh the benefit of greater transparency. In omnibus accounts, brokers aggregate trades from individual customers into one consolidated order for each mutual fund daily. For the fund involved, the customer is the broker, not the many individuals who own the shares being traded. That means funds are in the dark about frequent trading.

Increasing volatility in capital markets is now providing renewed opportunities for mutual fund arbitrage, according to the CMFI. Meanwhile, it added, as fund distribution channels grow, funds now risk losing control over the enforcement of their prospectus policies within the substantial majority of their shareholder accounts. "To make matters worse, fund companies continue to compensate intermediaries for 'servicing' shareholder accounts that are already their responsibility to manage as part of the customer relationship."

CMFI has asked the Commission to direct registration of all mutual fund shareholder accounts to systems offered by the National Security Clearing Corporation. Schapiro's response pointedly notes the investor group argues this could be done "at a relatively low cost." --Stan Wilson

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