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## J.P. Morgan Dumps Redemption Fees

By Hannah Glover March 22, 2011

J.P. Morgan Funds will eliminate redemption fees on 26 funds, joining a growing list of firms eliminating the fees initially meant to thwart market timing.

Starting May 2, J.P. Morgan will stop charging a 2% fee on shares held less than 60 days, according to a regulatory filing. Once the fees are repealed, J.P. Morgan will no longer have redemption fees on any of its funds.

“Shareholders are reminded that the Funds do not authorize market timing and the Funds will continue to use reasonable methods to identify market timers, including reviewing ‘round trips’ in and out of the Funds by investors and rejecting certain purchase and exchange orders,” the filing states.

J.P. Morgan joins several other firms in rolling back such fees. **Putnam, Mainstay, Henderson Global Funds, Van Kampen, Franklin Templeton, Hennessy Funds, First Eagle, Pimco, State Street Global Advisors, Oakmark and Forward Funds** have each eliminated such fees on some or all of their funds.

Of 7,822 funds offered since 2007, the number that levy redemption fees dropped from 827 in 2007 (10.6%), to 720 (9.2%) today, according to data provided by **Broadridge Financial Solutions**. Those figures are based on a Broadridge analysis of funds offered continuously from 2007 to March 2011.

Analysts say the risks of market timers targeting funds has been reduced thanks to improvements to technology, pricing practices and the increased trend toward third-party sales. What’s more, the rise of intermediary sales has, in some ways, also distanced firms from the front lines of implementing their own policies.

After the 2005 adoption of SEC rule 22c-2, fund boards were required to consider implementing the fees, which many at the time considered a best practice in discouraging short-term trading of funds. The rule was adopted with memories of the market timing scandal fresh in peoples’ minds. One concern with short-term trading was that it would drive up fees for other shareholders of the fund. Another worry was that the practice could be a drag on performance or encourage portfolio managers to keep above-average holdings in cash for instant liquidity.

In a [Q&A](#) about the firm’s decision to eliminate redemption fees posted on the firm’s site, J.P. Morgan says that the firm determined that the fees “are no longer necessary” and that the firm employs several strategies to detect abusive trading. For example, J.P. Morgan reviews so-called round-trip orders, or the purchase or exchange of a fund either immediately before or after a redemption or exchange in the same fund.

If the firm finds that an investor has completed two round-trips in a fund within 60 days, J.P. Morgan “will reject your purchase and exchange orders for a period of at least 90 days, according to a prospectus for the firm’s international equity funds. Repeat offenses could lead to a permanent block on that investor’s trades within the fund.

A spokeswoman for J.P. Morgan declined to say whether the firm has ever taken such measures.

Analysts say that the threat of investors using short-term arbitrage strategies in long-term funds has diminished. Non-U.S. equity funds proved especially susceptible to excessive trading during the dust-up over market timing because of stale pricing and time zone differences. Research from **Strategic Insight** shows that, since the end of 2003, redemption rate patterns between U.S. and non-U.S. equity funds have been “almost identical,” says senior research analyst, Dennis Bowden, in an e-mail response to questions.

One reason for that could be the implementation of fair-value pricing, which aims to avoid the mis-pricing of more illiquid or hard-to-price securities. Increased vigilance on the part of fund firms, spurred by the attention of fund boards and regulators, has also likely contributed to lessening the threat, says Bowden.

Improved recordkeeping systems have also helped better monitor exchanges and redemptions and crack down on abuse, says Andrew Gogerty, senior fund analyst with **Morningstar**. The rise of exchange-traded funds, which, like mutual funds, represent a basket of securities but can be traded or shorted throughout the day like a stock, may also contribute to the reduced threat, he says.

The number of platforms, such as **TD Ameritrade**, **Schwab** and **Fidelity**, that waive trading commissions for certain ETF products eliminates another barrier to using such products, he says. “Trying to time a trade in a traditional open-end mutual fund may not be the best way for those traders to get access,” Gogerty says.

Another factor pushing redemption fees closer to extinction may be the growth in the proportion of mutual fund sales made through third-party intermediaries, such as advisors or retirement plans. For one thing, investors who use intermediaries tend to have longer holding periods for their investments. For another, such trades are generally reported to fund companies as one omnibus account. Under SEC Rule 22c-2, funds that elect to impose short-term trading or redemption fees must have the ability to “look through” such accounts and get information on trades made in each of the underlying accounts.

J.P. Morgan, like scores of other firms, acknowledges that such reliance puts the firm’s ability to police improper trades at an arm’s length. “While the funds seek to monitor for market timing activities in omnibus accounts, the netting effect [of the sales reported to the firm] limits the Fund’s ability to locate and eliminate individual market timers,” the prospectus says. “As a result, the Funds are often dependent on Financial Intermediaries who utilize their own policies and procedures to identify market timers.”

The challenge is that even if fund companies have determined that their distribution partners have the technology in place to accurately capture and track the data, 22c-2 does not require intermediaries to deliver – or fund companies to request – these reports on any particular schedule. Fund companies can request the data when they choose, typically if they suspect abusive trades. “You get a snapshot of what is going on in the underlying accounts,” says Niels Holch, executive director of the **Coalition of Mutual Fund Investors**.

Holch asserts that, for the rule to truly be properly implemented, firms would have to request reports on a real-time or daily basis. “That would give mutual fund companies a lot more confidence about their [intermediaries’] uniformity and ability to apply their policies and procedures.”

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