# Navigating the Murky Waters of Omnibus Accounts

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The fund industry is increasingly reliant on the use of omnibus accounts, in which financial intermediaries assume responsibility for recordkeeping functions at the investor level. As interest continues, fund directors should pay attention to the unique set of fiduciary and operational challenges omnibus accounts present.

To be sure, the lack of transparency within an omnibus account stands out as a top obstacle. When an intermediary transacts in fund shares using an omnibus account, fund compliance personnel do not receive any information about the underlying shareholders or their share transactions. The ambiguity can cause disparate applications of fund prospectus policies within these intermediary accounts.

A second challenge is the fact that the costs for maintaining these accounts can be higher than traditional recordkeeping and shareholder servicing costs. Fund directors need to understand how omnibus accounts work on a day-to-day basis so that an effective oversight program can be developed and implemented. The following are several practical ways to evaluate and approach omnibus account oversight.

**Establish an Oversight Program for Omnibus Accounts**

After appropriate review and analysis of the fund's omnibus account arrangements, directors should ensure a strong compliance program is in place to oversee the activities and costs of these intermediary accounts.

The first priority is obtaining shareholder information from intermediaries. The National Securities Clearing Corporation offers a service called "networking" that permits full transparency down to the investor level. Many fund complexes like to use this service, but broker-dealers and other intermediaries are moving away from it for proprietary reasons. Fund directors should consider requiring that all intermediaries use it to ensure that fund prospectus policies are uniformly enforced at the shareholder level.

Another important issue is the cost of these distribution arrangements. Funds and their advisers are paying higher fees to support omnibus accounts than to support direct-sold accounts. The Coalition of Mutual Fund Investors estimates that individual investors are being charged more than $8 billion annually in account maintenance charges, shareholder servicing fees and revenue-sharing payments.

Some of these fees would have to be paid anyway to maintain shareholder accounts under other types of distribution arrangements. However, large broker-dealers and certain fund supermarket platforms are able to extract fees that are higher than market-based charges because of the leverage they exert over funds in the current distribution system. As part of a board's oversight of advisory and distribution fees, directors should consider requiring competitive bidding to make sure that recordkeeping and shareholder servicing fees reflect arm's-length bargaining and normal market forces.

**Require Regular Compliance Reports for Omnibus Accounts**

Once a compliance program is in place to address the transparency and cost issues involving omnibus accounts, directors should require regular progress reports. The updates need to come from the chief compliance officer, the transfer agent and any third parties involved in implementing the policies and procedures established by the board.

Under a properly designed program, a fund should be in a position to ensure the application of its prospectus policies uniformly to all shareholders and across all distribution channels. The costs for recordkeeping and shareholder services should be market-driven and not established solely through a fee schedule imposed on a fund by its intermediaries.

**Reevaluate the Oversight Program for Omnibus Accounts on a Regular Basis**

As new distribution arrangements are created, directors should evaluate them and revise their oversight program for the intermediaries involved. As the primary "watchdog" of shareholder interests, boards should look at the distribution system through the eyes of long-term fund investors. They should also develop policies and procedures that reflect this perspective.

Intermediaries argue that the use of omnibus accounts is a more efficient distribution model. If this is the case, why are investors losing protections from prospectus policies on important issues, such as market-timing procedures and sales load discounts? And why do investors have to incur higher expenses for an accounting model that is primarily designed to help broker-dealers and other intermediaries extract additional fee income?

Fortunately for the mutual fund industry, the technology exists for full transparency within omnibus accounts. And the use of competitive bidding processes can ensure that costs are market-based and not established through fee schedules fixed by fund intermediaries.

The needs of investors should not come second to the proprietary interests of intermediaries involved in the fund distribution system. Boards should take advantage of these tools and practices to ensure that long-term investors are protected.