May 6, 2005

The Honorable William H. Donaldson VIA REGULAR MAIL
Chairman
U.S. Securities and Exchange Commission
450 Fifth Street, NW
Washington, D.C. 20549

Subject: CMFI 2005 Market Timing Study

Dear Chairman Donaldson:

Enclosed is a summary of a new study released yesterday by the Coalition of Mutual Fund Investors (CMFI). The results of this study clearly demonstrate that the largest mutual fund groups are unable to monitor or stop market timing in shareholder accounts held by third-party financial intermediaries.

CFMI evaluated the 50 largest mutual fund groups for their use of redemption fees and other mutual fund policies aimed at deterring excessive short-term trading. The study actually involved a review of the SEC prospectus filings of these largest mutual fund groups. Since a significant percentage of mutual fund shares are sold by third-party intermediaries, CMFI evaluated the ability of a mutual fund to enforce its market timing policies uniformly under the omnibus account structure used by most of these intermediaries.

This is the second CMFI study on this topic. The Coalition found similar results in a study of prospectus filings completed in August of 2004.

The highlights of the 2005 CMFI study include the following:

- Many fund groups are using redemption fees as a tool to deter short-term trading. Of the 50 fund groups examined, 35 of the groups (70%) utilize a redemption fee for at least one equity mutual fund. This is an *increase of 6%* from last year's study, where 32 of the 50 fund groups utilized a redemption fee on at least one fund.

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- Almost all fund groups are disclosing in prospectus filings the impossibility of enforcing market timing restrictions on omnibus accounts. Of the 35 fund groups with redemption fee policies, 34 of the groups (97%) disclosed that they *exclude, waive, or limit the enforcement of redemption fees in omnibus accounts*. This is an *increase of 9%* from last year's study, where 28 of the 32 groups with redemption fee policies disclosed similar disclaimers in prospectus filings with the SEC.

- Almost all fund groups are using the FIFO accounting method, instead of the accounting method most effective in deterring abusive short-term trading. Of the 35 groups with redemption fee policies, 22 groups (63%) disclosed that they use the FIFO ("First In, First Out") accounting method to calculate redemption fees. *No fund group disclosed that it uses the LIFO ("Last In, First Out") accounting method,* despite the fact that it is the only accounting method that actually matches up market timing transactions, (i.e., the most recent purchases matched with the most recent redemptions).

After more than two years since abusive market timing activities were uncovered in omnibus accounts by regulatory investigations, CMFI remains concerned that redemption fees and other short-term trading restrictions are not being enforced uniformly—or fairly—among all mutual fund shareholders. It is clear that the widespread use of omnibus accounts is a significant obstacle to deterring trading abuses and ensuring consistent treatment for shareholders that is independent of the investment vehicle they have chosen.

The Coalition believes that the most sensible solution to this problem is to require *full transparency* within omnibus accounts. This can be accomplished by requiring intermediaries to disclose omnibus account identity and transaction information when placing trading orders, so that funds can monitor shareholder activity and be in a position to ensure uniformity in the enforcement of their policies.

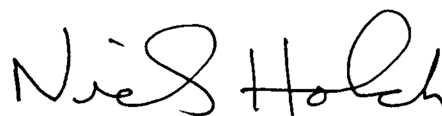
Remarkably, CMFI research has determined that the most cost-effective way to accomplish same-day disclosure of omnibus account information is to take advantage of the technology in use today by the National Securities Clearing Corporation, which is already exchanging order and account information for the substantial majority of funds and their intermediaries. With relatively modest adjustments to this technology, a more transparent system can be created for most of the largest financial institutions in a more cost effective manner than weekly, monthly, or "upon request" reporting by intermediaries to funds.

As a result of this study, CMFI is also concerned that the persistent use of FIFO by the mutual fund industry will permit market timers to circumvent redemption fee policies. The use of LIFO should be encouraged instead because it is the only accounting method that accurately matches short-term trading transactions.

A more detailed summary of the 2005 CMFI study is attached for your review. Copies of both the 2004 and 2005 CMFI studies can be found on the Coalition's Website at www.investorscoalition.com. If you or your staff have any questions or need more information about these studies or the analysis that CMFI used, please feel free to contact me.

As always, the Coalition and its individual investor members appreciate your leadership in improving the federal mutual fund regulatory framework, for the benefit of all investors.

Sincerely,



Niels Holch
Executive Director
Coalition of Mutual Fund Investors

Attachment

cc: The Honorable Paul S. Atkins
The Honorable Roel C. Campos
The Honorable Cynthia Glassman
The Honorable Harvey J. Goldschmid
Meyer Eisenberg (Division of Investment Management)
Robert Plaze (Division of Investment Management)