CMFI

Coalition of Mutual Fund Investors

August 18, 2010

The Honorable Mary L. Schapiro
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549

Dear Chairman Schapiro:

The Coalition of Mutual Fund Investors ("CMFI")[1] has documented several practices being used by large broker-dealers to increase their revenues from mutual fund activities. CMFI estimates that these practices are imposing annual costs on individual investors of as much as: (1) $2.2 billion in account maintenance charges, (2) more than $4.18 billion in shareholder servicing payments, and (3) more than $2.09 billion in revenue-sharing payments.

Attached to this letter is a CMFI White Paper, which explains in greater detail these broker-dealer practices and the harm they are causing to individual investors. The CMFI White Paper also recommends several solutions that will address these practices through regulatory action.

Investors who are using mutual funds to save for their retirement, or to send their children to college, are seeing their assets and investment earnings being depleted by these broker-dealer costs. And, ironically, a number of these large broker-dealer intermediaries were recipients of bailout money from the federal government's Troubled Asset Relief Program ("TARP").

As the primary distributors of fund shares, large broker-dealers have substantial leverage over mutual funds. These broker-dealers are using this leverage to convert individual mutual funds accounts onto the "street name" accounting platforms operated by brokerage firms.[2] This conversion allows certain mutual fund shareholder accounts to reside only on the books of broker-dealers, creating an opportunity for brokerage firms to

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[1] The Coalition of Mutual Fund Investors ("CMFI") is an Internet-based shareholder advocacy organization established to represent the interests of individual mutual fund investors. You can learn more about the Coalition and its advocacy activities at www.investorscoalition.com.

[2] Within the financial services industry, this accounting and recordkeeping process is called "omnibus sub-accounting." The consolidated account of an individual brokerage firm's customers is recognized on a mutual fund's books and records as an "omnibus account."

400 North Capitol Street, N.W. ■ Suite 585 ■ Washington, D.C. 20001
Telephone 202-624-1460 ■ Fax 202-393-5218 ■ www.investorscoalition.com

charge significant fees to mutual funds and their individual investors, in addition to the fees already being charged for sales and distribution.

CMFI believes that this conversion of mutual fund accounts onto the accounting platforms of brokers has been increasing steadily over the past decade, and will continue to increase as brokerage firms seek additional sources of revenue and as they emerge from the recent financial crisis.

The fees charged by broker-dealers for maintaining shareholder accounts are primarily paid by mutual funds as an expense from fund assets, thereby imposing costs on shareholders who have no customer relationship with these brokerage firms. These fees are also being paid for account maintenance and shareholder servicing activities that—under existing regulatory rules—are already the responsibility of broker-dealers to perform for their customers.

Remarkably, the payment of these fees to broker-dealers is not creating additional protections for individual investors. In fact the opposite is taking place, as trading activities and investor identities within these broker-controlled shareholder accounts remain *hidden* from mutual fund compliance personnel attempting to apply prospectus policies and procedures in a uniform and consistent manner across shareholder classes.

In addition to the cost to investors of these account maintenance and shareholder servicing fees by large broker-dealers, the lack of transparency within hidden mutual fund accounts raises a number of significant regulatory problems:

- Mutual funds are not able to monitor excessive short-term trading activities in these intermediary accounts on a real-time basis;

- Investors in sales load funds may not be receiving the proper volume or breakpoint discounts, as promised in fund prospectus filings;

- Money market funds are not able to accurately evaluate and manage their liquidity risks because of an inability to access investor identity and transaction information through this broker-dealer accounting structure; and

- Distributions to individual investors from the SEC Fair Funds program cannot be made in a precise and timely manner because of the lack of transparency within these hidden accounts at the investor level.

One very positive step the SEC has taken in this area is to promulgate an intermediary information-sharing rule—Rule 22c-2—to address the lack of transparency within hidden mutual fund accounts. However, CMFI's most recent review of mutual fund prospectus filings indicates that funds are <u>not</u> taking advantage of the Rule by requesting investor-level information from broker-dealers.[3] Given the leverage large broker-dealers have over mutual funds as their primary distribution agents, it is no surprise that this new Rule has proven to be somewhat ineffective.

Unless some action is taken, these increasing broker-dealer costs and continuing regulatory problems affecting hidden mutual fund accounts will continue to negatively impact the 87 million Americans who rely on mutual funds to save for retirement, college education, and other important goals.

CMFI requests that the SEC engage in a further evaluation of this problem and take appropriate regulatory action to protect individual investors from these unnecessary costs and ensure full transparency within these hidden shareholder accounts.

Thank you for your consideration of this CMFI research and White Paper.

Sincerely,

Niels Holch

Niels Holch
Executive Director
Coalition of Mutual Fund Investors

Attachment

cc: The Honorable Kathleen L. Casey
The Honorable Elisse B. Walter
The Honorable Luis A. Aguilar
The Honorable Troy A. Paredes
Andrew Donohue, Division of Investment Management
Robert Plaze, Division of Investment Management
Lori Schock, Office of Investor Education and Advocacy
Richard Ferlauto, Office of Investor Education and Advocacy
Henry Hu, Division of Risk, Strategy, and Financial Innovation

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[3] See Coalition of Mutual Fund Investors, Excerpts from SEC Prospectus Filings Regarding Enforcement of Mutual Fund Market Timing and Other Short-Term Trading Policies within Third-Party Hidden Accounts, March 1, 2010, available at http://www.investorscoalition.com/Prospectus_Filings.pdf.