CMFI
Coalition of Mutual Fund Investors

MUTUAL FUND INDUSTRY UNABLE TO STOP MARKET TIMING IN 3RD PARTY ACCOUNTS

NEW CMFI STUDY REVEALS LACK OF UNIFORMITY IN OMNIBUS ACCOUNT ENFORCEMENT

Washington, D.C., May 5, 2005—The Coalition of Mutual Fund Investors (CMFI) today released the results of a new study demonstrating that the largest mutual fund groups are unable to monitor or stop market timing in shareholder accounts held by third-party financial institutions.

The CMFI study evaluated the 50 largest mutual fund groups for the use of redemption fees and other mutual fund policies aimed at deterring excessive short-term trading. Since a significant percentage of mutual fund shares are sold by third-party financial institutions—called fund intermediaries—the CMFI study evaluated the ability of a mutual fund to enforce its market timing policies uniformly under the accounting structure used by these institutions, called "omnibus accounts."

The study concluded that it is impossible for mutual funds to effectively enforce their policies because many of their customers are concealed in third-party omnibus accounts. With only one exception, all of the fund groups with redemption fee policies (97%) disclosed in prospectus filings that they are currently excluding, waiving, or limiting the enforcement of redemption fees in omnibus accounts.

The study also found that mutual funds are not using the most effective accounting method, LIFO ("Last In, First Out"), to calculate redemption fees.

"CMFI remains very concerned that market timing policies are not being enforced uniformly among all mutual fund shareholders because of a lack of transparency in omnibus accounts," said Niels Holch, Executive Director of CMFI and the author of the study. "These study results prove that the widespread use of omnibus accounting is a significant obstacle to curbing market timing activities."

Many third-party financial institutions buy and sell mutual funds through omnibus accounts, in which the intermediary consolidates all of its mutual fund transactions into one order during each trading day. Each omnibus account order may represent the transactions of hundreds of thousands of customers, yet no individual identity or transaction information is disclosed to the mutual fund. By examining these fund groups' recent public filings with the U.S. Securities and Exchange Commission (SEC), the CMFI study concludes that the use of these omnibus accounts makes it impossible for mutual funds to enforce their anti-market timing policies within these third-party accounts. This is the second CMFI study on this topic; CMFI found similar results in a study completed in August of 2004.

Some of the highlights of the 2005 CMFI study include:

- <u>More fund groups are using redemption fees as a tool to deter short-term trading</u>. 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.

- <u>More fund groups are disclosing in prospectus filings the impossibility of enforcing market timing restrictions on omnibus accounts</u>. 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.

- More 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).

"To really address the market timing issue, financial intermediaries should be required to disclose omnibus account information with every trading order so that funds can monitor shareholder activity and be in a position to ensure uniformity in the enforcement of their policies," Holch said. "As a further step, mutual funds should consider using the LIFO accounting method because it is the only method that accurately matches short-term trading transactions."

CMFI is an Internet-based shareholder advocacy organization representing the interests of individual mutual fund investors. Copies of both the 2004 and 2005 CMFI studies can be found on the CMFI Website at www.investorscoalition.com.

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