

Despite Waning Adoption, Redemption Fees Here to Stay: Lawyers

By Jill Gregorie, *Ignites*, September 22, 2016 [subscription required]

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When it was first proposed as a measure to prevent market timing within mutual funds, the SEC's so-called redemption fee rule garnered significant backlash from industry participants, who cited the high operational hurdles and cost of compliance it would involve.

One acting SEC commissioner described the initial proposal to the *The Wall Street Journal* as "half-baked" and ill-advised.

Nearly a decade later, the SEC is revisiting Rule 22c-2 as part of a mandatory review, and industry lawyers say that fund companies and their intermediaries are unlikely to push for its repeal, or any change to the SEC's April 2007 provision.

For one thing, the advent of easy-to-trade, highly liquid exchange-traded funds has diminished the risk of hedge funds or others large investors' harming smaller investors to use funds to time markets. For another, there are plenty of other pending rules to focus on, lawyers say.

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Still, at least one lawyer feels that the 10-year review provides an opportunity to make the rule more effective.

The proliferation of omnibus accounts has obscured firms' ability to pinpoint which fund investors are executing what trades. In an omnibus arrangement, the broker-dealer or other distributor makes only one trade with the mutual fund provider, and then divvies up the shares among the appropriate shareholder accounts.

As a result, it is hard to detect instances of trading abuse, says Niels Holch, partner at Holch & Erickson, and executive director of the Coalition of Mutual Fund Investors. "Everyone thinks we've solved the market timing problem, but I'm not sure that we have," he says.

To address that, Holch suggests that the SEC require broker-dealers and other intermediaries trade through the **National Securities Clearing Corporation** (NSCC), which is designed to provide fund companies with daily transparency into the transactions occurring in omnibus and super omnibus accounts.

Broker-dealers can have hundreds or even thousands of funds on their platforms, and are responsible for applying the relevant waivers, discounts and transactional fees for each.

“Investors are not getting what their prospectuses promised, whereas ‘direct purchase’ customers get exactly what they’re promised. It’s creating a disparity that I don’t think is fair,” he adds.