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New Advocacy Group Issues Fund Reform Ideas

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The Coalition of Mutual Fund Investors, an investor-advocacy group founded in the wake of the fund scandal, has been pushing for a series of reforms that go beyond the Baker bill's recommendation.

The coalition supports the Baker bill, says Niels Holch, a partner at Washington, D.C., law firm **McGuiness & Holch**, which formed the group. But at the same time, it believes that the bill doesn't go far enough in certain key areas, he says.

The group wants to go above and beyond what existing legislative proposals require in the way of disclosure on everything from omnibus accounting to fees and expenses to trading costs.

Some of those changes could wind up costing fund firms a lot of money. Others are changes that the fund industry and the broker-dealer community have been resisting for a long time now.

Probably the most significant reform the coalition is backing consists of big changes to omnibus accounting. Those are accounts in which a large intermediary, such as a brokerage or a retirement plan, aggregates all its trades in a given mutual fund into one large trade.

That practice has made it much more difficult for fund firms to monitor for some of the abuses that have been at the root of the current industry scandal, says Holch. In its settlement with Eliot Spitzer, hedge fund group **Canary Capital Partners** revealed that its market-timing and late-trading activities were obscured from funds within omnibus accounts.

In fact, many market timers use omnibus accounts to conceal their frequent trading activities. Also, most firms waive their funds' redemption fees within omnibus accounts because the sheer size and opaqueness of the accounts make it nearly impossible to enforce them. Because fund firms can't keep track of the investors within omnibus accounts, they must rely on agreements with the intermediaries selling their funds to do so.

Omnibus accounting has made it difficult for firms to enforce a number of regulations pertaining to market timing and other abuses, says Jeff Keil, vice president of fiduciary review at fund researcher **Lipper**.

The coalition's proposal for changing omnibus accounting, about which Holch sent SEC chairman William Donaldson a letter yesterday, would change that system. Under its proposal, intermediaries would pass along all shareholder identity and transaction information from omnibus accounts to fund firms, he says.

Fund firms have long wanted such a change, says Lee Gremillion, an industry consultant and faculty chair of information technology at **Capella University** in Minneapolis. Having direct access to shareholder information would be a great help to fund firms in marketing directly to shareholders, he says. It is exactly for that reason that intermediaries, aiming to maintain control over their clients, have opposed it, he says.

But according to the proposal Holch describes in his letter to Donaldson, fund firms would be prohibited from using the information for marketing or client-relationship purposes.

The aim of the coalition's proposed changes to omnibus accounting is to make sure that shareholders invested directly in the fund get the same treatment as investors who have bought shares through an intermediary, he says. It will also help prevent other abuses that have hurt the fund industry, such as brokers' failing to give investors proper fund breakpoints, he says.

If fund firms had access to shareholder information, they would be able to make sure investors received any breakpoint discounts they were owed, Holch says. Fund firms would also be motivated to do so, because money that doesn't go to brokers goes to the fund, from which they earn their fees, he says.

One of the biggest drawbacks to the proposed reform of the omnibus accounting system is cost, says Keil.

The biggest costs would come for broker-dealers, whose systems are geared toward sending out large, aggregated trades, says Keil. In many cases, the trading systems at broker-dealers are 10 years old, he says. With the markets struggling in recent years, updating or replacing trading systems hasn't been a priority, he says.

The main costs for fund firms would be in paying for the data transmission and recordkeeping of the shareholder information they'd get from broker-dealers, says Gremillion.

Most fund firms already pay the intermediaries who sell their funds for the recordkeeping they do in omnibus accounts, says one industry observer. Under the coalition's proposal, they would have to pay for that recordkeeping on both the intermediary's end as well as on their own end, he says.

But looked at another way, those added costs would be relatively minor, says Holch.

"Look at the cost to the industry of the scandal," he says.

The coalition would also like to see fund fees broken out in dollar amounts in shareholder statements according to what each individual shareholder pays, says Holch.

That's a reform that people have been talking about for a while, says Gremillion. And it's one that wouldn't cost much, either, provided that relatively simple accounting methods are used, he says. Fund companies have resisted such a step because it makes their fees too explicit to investors, he says.

The coalition also wants rules requiring similar disclosure of a fund's trading expenses and rules requiring fund firms to put their funds' statements of additional information on their websites, says Holch. It is also pulling for a rule requiring that funds disclose all payments funds and fund firms make to brokerages, regardless of whether or not the payments directly facilitate sales of their funds, he says.

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