Redemption Fees Thwarted by Omnibus Accounts

By Julie Segal, Institutional Investor, June 3, 2005

Seventy-percent of the top 50 fund companies use redemption fees in an attempt to ward off market timers, but 97% of those exclude, waive or limit the enforcement of those fees for omnibus accounts. According to a new study by the Coalition for Mutual Fund Investors, a shareholder advocacy group, of the 50 groups examined, 35 of the groups use a redemption fee on at least one equity fund, up 6% from last year. The results of the study are important to the industry, say industry observers, because an increasing number of fund companies are using redemption fees as a way to cut profits for timers and ultimately reduce the attraction of timing.

But redemption fees – which can be costly to long-term investors – are ineffective if timers can game the system by entering the market through a large intermediary, an omnibus provider. Timers can effectively continue to game mutual funds and skim off profits, these observers say. “More funds are disclosing in the prospectus filings the impossibility of enforcing market timing restrictions on omnibus accounts,” said Niels Holch, executive director of the Coalition.

Holch said the study found that 97% of fund groups that exclude or limit redemption fees for omnibus accounts is a 9% increase from last year’s study.

Holch also pointed out that the method of assessing the fee that most fund groups actually use is not the most effective in deterring timing activity. Although the issue is technical, it has real-world implications, he said. Sixty-three percent of the fund groups evaluated use the first-in, first-out method, whereas the Coalition believes in a last-in, last-out method that matches up timing transactions. “This is the method that matches the most recent purchases to the most recent redemptions,” he said.