CMFI
Coalition of Mutual Fund Investors

June 26, 2007

The Honorable Christopher Cox
Chairman
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Subject: Mutual Fund Omnibus Accounts

Dear Mr. Chairman:

Attached is a new study by the Coalition of Mutual Fund Investors (CMFI), examining the enforcement of mutual fund market timing policies within shareholder accounts held by third-party financial intermediaries. This is the third study by CMFI on this issue since the mutual fund scandals of several years ago.

This latest CMFI study evaluates the use of redemption fees and other mutual fund policies aimed at deterring excessive short-term trading by the 50 largest mutual fund groups. Since the substantial majority of mutual funds are sold by financial intermediaries—such as broker-dealers, financial advisors and retirement plans—the CMFI study assesses the ability of a mutual fund to enforce its market timing policies within omnibus accounts, the accounting and order system used by these intermediaries.

The study concludes that mutual funds are *not* able to uniformly enforce their policies because of a lack of transparency in these third-party accounts. All 50 fund groups now disclose in their most recent prospectus filings that they have no choice but to consider *waiving, excluding or limiting* the enforcement of their short-term trading policies within omnibus accounts.

The Commission has moved to address this problem by promulgating new Rule 22c-2.[1] Rule 22c-2 now requires that funds enter into written information-sharing agreements with all financial intermediaries. These agreements permit funds to request investor-level identity and transaction information from intermediaries using omnibus accounts.

[1] Mutual Fund Redemption Fees, 70 Fed. Reg. 13,328 (Mar. 18, 2005), 71 Fed. Reg. 11,351 (Mar. 7, 2006), and 71 Fed. Reg. 58,257 (Oct. 3, 2006), codified at 17 C.F.R. 270.22c-2.

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While full transparency within omnibus accounts is clearly the right solution to this problem, Rule 22c-2 is flawed in that it requires only that an intermediary provide investor-level information "upon request." Each mutual fund can be expected to impose different timetables and procedures on its intermediaries in implementing Rule 22c-2. Some will request shareholder identity and transaction information on a periodic basis (e.g. quarterly, monthly, weekly or daily). Others will request this information when a review of aggregated order patterns raises suspicions and a need for investor-level data.

CMFI's review of the prospectus filings of the top 50 mutual fund groups reveals that a number of funds plan to request this information only when a suspicious pattern is detected in omnibus order information. By their very structure, omnibus accounts conceal individual account activity; a summary review of aggregate data is not going to produce satisfactory results in uncovering excessive short-term trading activities.

Mutual funds and their intermediaries are also going to find that an "upon request" standard will be expensive to implement. Funds are free to adopt a myriad of compliance approaches, and intermediaries will be faced with having to respond to information requests that will differ from fund to fund.

This information-sharing requirement needs to be standardized. Fortunately, there is a technological solution that is both effective and inexpensive to use. More than 80% of the large intermediaries and funds use the processing systems of the National Securities Clearing Corporation (NSCC) to exchange mutual fund order and account information on a same-day basis.

The NSCC has developed a standardized method for exchanging this information on a daily basis or as orders are placed. The cost of exchanging this information is currently 15 cents for every 100 records.[2] The financial services industry and the investors they serve can save millions of dollars by requiring all mutual funds and their intermediaries to share this information on a same-day basis. This step would provide *full transparency* in omnibus accounts, permitting funds to ensure that redemption fees and other short-term trading policies are enforced accurately and uniformly. An additional benefit to standardizing Rule 22c-2 is the fact that other corporate actions, such as the proper calculation of fund-specific sales load discounts (i.e. breakpoint discounts), another problem uncovered by the recent fund scandals, can also be handled in a more precise manner than current practices allow.

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[2] Mutual Fund Services Experience Record Year of Performance, Wealth Management Services Quarterly, Spring 2007, available at http://www.dtcc.com/Publications/wms-quarterly/vol1.pdf.

It has been almost five years since the market timing and late trading scandals were uncovered by the Commission staff and several state regulators. Many of the most egregious improper trading activities occurred in omnibus accounts. The Commission should be concerned that a significant lack of transparency still exists within these accounts, as demonstrated by this new CMFI study of mutual fund prospectus filings.

The proper use of technology already being used by the financial services industry can supply a "win-win" solution to this problem. Rule 22c-2 should be standardized to require the sharing of investor-level identity and transaction information on a same-day basis. The systems to implement this standard already exist and can be deployed in a very cost-efficient manner. And daily information-sharing also presents the Commission with a real solution to the problem of ensuring that breakpoint discounts of sales load charges are calculated correctly.

CMFI urges the Commission to improve Rule 22c-2 so that full transparency within omnibus accounts can be achieved. If CMFI can be of further assistance to the Commission as it continues its evaluation of these mutual fund issues, please let me know.

Sincerely,

Niels Holch

Niels Holch
Executive Director
Coalition of Mutual Fund Investors

Attachments (2)

cc: The Honorable Paul S. Atkins
The Honorable Roel C. Campos
The Honorable Kathleen L. Casey
The Honorable Annette L. Nazareth
Andrew Donahue, Division of Investment Management
Robert Plaze, Division of Investment Management
C. Hunter Jones, Division of Investment Management
Thoreau Bartmann, Division of Investment Management