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Hennessy Joins Trend, Sheds Redemption Fees

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Hennessy Funds is the latest in a string of fund groups to eliminate redemption fees on its funds.

The change is effective today. Other groups that also have recently dropped redemption fees for some or all of their funds include **Franklin**, **DWS**, **Pimco**, **State Street Global Advisors**, **First Eagle**, **Oakmark** and **Forward Funds**.

"We, like other fund companies, have done a lot of evaluating of our experience with our redemption fees and found that they're really not needed anymore to mitigate any market timers," says Kevin Rowell, president of the Hennessy Funds.

The Hennessy funds' fair valuation processes and the compliance department's monitoring of trades are doing the job of thwarting market timers, he says. In addition, all of the Hennessy funds are domestic, whereas funds that historically have been targeted by market timers are international or small-cap, he says.

Some fund groups started dropping redemption fees following the adoption of the SEC's Rule 22c-2, which became effective last October. The rule effectively gave fund groups the ability to monitor the underlying trades occurring in omnibus accounts. Omnibus accounts batch together individual investors' fund share purchases and redemptions into net orders. The orders are transmitted to fund firms, and in the past, fund groups were not able to access underlying information about the individual trades occurring in the account.

But with the advent of Rule 22c-2, funds and intermediaries were required to forge information-sharing agreements that permit the fund to request and receive that data. The SEC's logic was that armed with this data, fund groups would be better able to detect timing in their funds.

Still, the fact that funds can now obtain this information does not mean they are all doing it on a frequent basis, says Niels Holch, executive director of the **Coalition of Mutual Fund Investors**.

"Many of the funds are not doing it on a daily basis. I'm advocating that we do it on a regular basis so that we can catch the timers," says Holch.

In fact, one SEC official recently reminded the industry that the days of widespread market timing may not be over. Gene Gohlke, associate director of the SEC's Office of Compliance, Inspections and Examinations, told attendees at a conference in April that recent stock volatility has created opportunities for timers. He said fund firms need to remain vigilant that timing is not taking place.

As of today, about 26% of funds have redemption fees in place, according to Jeff Levering, vice president of corporate development at NewRiver. (Data for previous periods was not available by deadline.) NewRiver tracks market-timing policies for more than 24,000 funds. The Andover, Mass.-based firm tags data from funds' regulatory filings and offers products based on that data.

Many fund groups adopted redemption fees in the wake of the market-timing scandal when the SEC proposed a rule that would have made it mandatory for funds to impose a 2% redemption fee for shares bought and sold within the previous five days. In the end, after considerable outcry from the fund industry, the final rule did not make redemption fees mandatory. Instead, funds must consider only whether to put the fees in place.

Numerous groups that adopted the fee have since reassessed their operations and decided to eliminate it.

In addition to the stepped-up use of fair value pricing and closer monitoring of trading to deter timers, other means of combating abusive trading have grown in recent years.

Use of account trading blocks as a way to thwart market timing has increased considerably. In 2006, there were 1,700 funds that had account blocks in place, or 8% of funds; today there are 5,208 funds, or about 21% of the industry, that have account block provisions, says Levering.

Account blocks, which freeze trading in the fund account, are typically for a period of 30 to 90 days, although they sometimes extend to as long as a year, he says.

NewRiver found that funds limiting the number of an investor's permitted round-trip trades have also increased. Two years ago, about 6,066 funds, or 28% of all funds, had round-trip limitations. That has increased to 7,919 funds in 2008, or a third of all funds.

Another factor may also be driving certain funds to get rid of redemption fees: the Pension Protection Act, passed in 2006. Under the law, employers may automatically enroll new employees who don't choose a retirement investment option in several types of funds, including balanced and target-date funds. But in order for funds to qualify as default investments, they can't impose a penalty on investors for moving their money within 90 days. In other words, fees for redemptions within 90 days make balanced and target-date funds ineligible as default investments.

Some firms have cut redemption fees on their balanced and target-date funds. It appears that the law's requirements may be behind DWS's decision to remove redemption fees on its DWS Balanced Fund and a number of other target-date funds. The change went into effect in April, according to a regulatory disclosure.

DWS did not return a request for comment by deadline.

Hennessy's redemption fees had been in place since 2000, says Rowell.

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