

Money Fund Report®

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LEADING THE INDUSTRY IN MONEY FUND NEWS

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◆ CMFI OFFERS SOLUTION TO MMF OMNIBUS-ACCOUNT CHALLENGE

Many of the nearly 1,450 letters commenting on the money-market fund reform proposal released in June by the Securities and Exchange Commission, and virtually all of the substantial letters, have addressed the complications of distinguishing between retail and institutional funds, and the significant operational challenges of complying with the Commission's two main alternative proposals.

Both proposals – the retail exemption to the floating net-asset-value for prime institutional funds and the imposition of redemption gates and fees – depend on greater fund-level transparency into omnibus accounts used increasingly by broker-dealers and financial intermediaries, Niels Holch, executive director of the Coalition of Mutual Fund Investors, told *Money Fund Report*® recently. CMFI's comment letter suggested a strategy for achieving greater transparency that can reduce both the complexity and the cost of compliance.

"Concerns about omnibus accounts are mentioned frequently in the comment letters," Holch noted, "and it's something that must be addressed if the SEC really wants to move forward with reforms that are fair to investors, regardless of a fund's distribution channel." He added that fund managers and regulators have worked hard to improve transparency in the securities held in fund portfolios, but that the industry and regulators "need to work harder to improve transparency into the customer base."

"Unless the Commission mandates transparency – which it didn't do in its current proposal – it will continue to be nearly impossible," Holch said, "for a fund to know what's going on beyond the aggregated orders it receives every day." Similarly challenging, he said, would be compliance with the SEC's current proposals.

The challenge of applying either or both SEC reform proposals concerns the proportion of fund shares – about 80 percent, CMFI indicates in its comment letter – transacted through intermediaries, who become the shareholders of record in omnibus accounts. Although in the first of its proposals the Commission acknowledges the need for funds to develop policies that prohibit underlying retail investors from redeeming more than \$1 million per day, "it does not provide money-market funds with any tools that would allow intermediaries to assure that the daily redemption limit is not exceeded for any one stakeholder," particularly if some investors "game" the system by creating multiple accounts.

Opacity in omnibus accounts extends to the SEC's fees and gates proposal as well, CMFI said. When a fund's weekly liquid assets fall below 15 percent of its total assets, the SEC's proposed 2 percent redemption fee would have to be imposed by the intermediary, not by the fund. The fee, however, would be imposed without "any type of robust oversight."

The SEC's remedy – that funds should "review their contractual arrangements with financial intermediaries . . . to ensure that fees are appropriately applied to beneficial owners" – hasn't worked very well for mutual funds seeking to deter excessive trading," CMFI noted. The fee problem is compounded, the letter added, by the discretion the SEC gives fund boards to impose liquidity fees lower than 2 percent. In a financial crisis, CMFI said, "intermediaries offering multiple fund vehicles may need to impose differing fees depending on the redemption-fee policy adopted by each fund board."

A Potential Solution

"The most efficient and effective way to resolve the omnibus-account transparency problem is to extend SEC Rule 22c-2 to

money-market funds," CMFI suggested. The rule applies to mutual funds but exempts MMFs and requires financial intermediaries, on request, to provide mutual funds with shareholder-level identity and transaction information. Holch stated that the SEC made funds responsible for establishing information-sharing relationships with their intermediaries, and compliance was less than universal.

If amended to apply to money-market funds and to mandate intermediaries to share information with funds daily and in real time, rather than merely when requested by a fund, a "same-day" per-order disclosure regime could be created and managed, CMFI said, through the National Securities Clearing Corporation Networking Service. NSCC's Fund/SERV service, over which most mutual and money-market fund orders are currently placed, and its "Networking" service, which can track fund purchases down to the level of beneficial owner, together provide "an efficient processing platform that facilitates the electronic sharing and reconciliation of shareholder-level information between funds and financial intermediaries for compliance purposes," Holch told *MFR*.

Regulators Must Lead

Through the NSCC and its purchase order and networking and services, "a fund will record an aggregated transaction on its books, a broker-dealer will have the same transaction for a beneficial owner on its books, and transactions are reconciled daily," Holch said. The system allows a fund to monitor the activities of its underlying shareholders, while allowing broker-dealers to control the relationships with their clients.

Over the past decade or so, however, broker-dealers have begun moving customer accounts onto their own proprietary platforms. That, Holch noted, "is among the reasons we have this transparency problem. The recommendation I make in the comment letter to the SEC is simply, 'Let's go back to using the platform. It's inexpensive, market participants know and understand it, and it can be customized and adapted fairly depending on the specific regulations the SEC may want to require funds to comply with.'"

"The NSCC system is the answer to the omnibus problem," Holch said. He added, though, that its success will rely on regulators, including the SEC and the Financial Stability Oversight Council.

"If regulators really want to help solve this problem, they need to mandate that intermediaries provide this beneficial-owner information," Holch said. "That would make regulatory compliance easier and, not coincidentally, strengthen and prepare the industry for the next financial crisis."♦

MFR COMMENTARY

Net assets of 1,022 Taxable MMFs increased \$36.91 billion to \$2.405 trillion as of Sept. 24. Total Taxable Institutional fund assets were up by \$37.68 billion. Taxable Retail fund assets decreased \$774.9 million.

The iMoneyNet Money Fund Average™/All Taxable 7-Day Yield remained at 0.01 percent for a 19th straight week. The All Taxable 30-Day Yield held steady at 0.01 percent for a 16th consecutive week. The Taxable WAM shortened to 48 days from 49 days the previous week.

Net assets of 420 Tax-Free and Municipal MMFs decreased \$2.27 billion, bringing the total to \$263.74 billion as of Sept. 23.

The iMoneyNet Money Fund Average™/All Tax-Free 7-Day Yield was unchanged at 0.01 percent for a 21st consecutive week. The All Tax-Free 30-Day Yield remained at 0.01 percent for a 39th straight week. The Tax-Free WAM lengthened to 43 days from 42 days the week before.

Total net assets of 1,442 Taxable and Tax-Free money funds settled at \$2.668 trillion, a one-week increase of \$34.64 billion.