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Contact: Niels Holch

202-624-1461

MUTUAL FUNDS UNABLE TO STOP ARBITRAGE TRADING IN 3rd PARTY ACCOUNTS

Third CMFI Study Demonstrates Regulatory Problems in Omnibus Accounts

Washington, D.C., June 20, 2007 – The Coalition of Mutual Fund Investors (CMFI) today released the results of the organization’s third study demonstrating that the largest mutual fund groups are unable to address arbitrage trading in shareholder accounts held by third-party financial institutions.

The CMFI study evaluated 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 most mutual funds are sold by third-party financial intermediaries—such as broker-dealers, financial advisors, and retirement plans—the CMFI study evaluated the ability of a mutual fund to enforce its short-term trading or market timing policies uniformly in “omnibus accounts,” the accounting and order system used by these intermediaries.

The study concluded that it is impossible for mutual funds to effectively enforce their policies because of a lack of transparency in these third-party accounts. All of the fund groups (100%) disclosed in prospectus filings with the U.S. Securities & Exchange Commission (SEC) that they have no choice but to consider excluding, waiving or limiting the enforcement of their short-term trading policies in omnibus accounts.

The study also determined that mutual funds are not using the most effective accounting method (LIFO or “Last In, First Out”) to calculate redemption fees.

“The use of omnibus accounting continues to prevent mutual funds from uniformly enforcing their short-term trading policies,” said Niels Holch, CMFI Executive Director and the author of the study. “Retail investors are not being protected from harmful arbitrage transactions and this regulatory problem should be addressed by the industry and its regulators.”

Many third-party financial institutions buy and sell mutual funds by consolidating all of their customer transactions into one order during each trading day. Each “omnibus account” order may represent the transactions of thousands of customers, yet no identity or transaction information about individual shareholders is generally disclosed to the mutual fund. After examining recent prospectus filings with the SEC by these mutual fund groups, the CMFI study concludes that the current use of omnibus accounts makes it impossible for mutual funds to enforce their short-term trading policies within these third-party accounts.

This is the third CMFI study on this topic. CMFI found similar results in studies released in August of 2004 and May of 2005. All of these studies can be located on the CMFI website at www.investorcoalition.com.

Highlights of the 2007 CMFI omnibus account study include the following:

- Most mutual fund groups continue to use redemption fees as a tool to deter short-term trading abuses. Of the 50 fund groups evaluated, 31 of the groups (62%) have implemented redemption fees on at least one domestic or international equity fund. This is a *decrease of 8%* from the 2005 study, where 70% of the fund groups utilized a redemption fee on at least one fund.
- All fund groups are now disclosing in prospectus materials the impossibility of enforcing redemption fees or other short-term trading policies within omnibus accounts. Every one of the fund groups with redemption fee policies (100%) disclosed that the funds may exclude, waive, or limit the enforcement of redemption fees in omnibus accounts. This is an *increase of 3%* from the 2005 study, where 97% of the fund groups disclosed exclusions, waivers, and limitations on enforcement within omnibus accounts. For fund groups with other short-term trading policies, every one of these groups (100%) disclosed concerns about the ability or practicality of enforcing these policies in omnibus accounts. This is an *increase of 47%* from the results of the 2005 study.
- None of the large fund groups use the LIFO accounting method, despite its effectiveness in deterring abusive short-term trading. Of the 31 groups with redemption fee policies, 26 groups (84%) disclosed that they use the FIFO (“First In, First Out”) accounting method to calculate redemption fees. No fund group disclosed that it uses the LIFO accounting method, despite the fact that it is the only accounting method that actually matches up market timing transactions (*i.e.*, the most recent purchases matched with the most recent redemptions).

“The best process for uniformly protecting retail investors from arbitrage trading is to require intermediaries to disclose shareholder information on a daily basis so that funds can actively monitor shareholder transaction activity on a real-time basis,” Holch said. “As an additional step, mutual funds should use the LIFO accounting method in calculating redemption fees because it is the only method that accurately matches short-term trading transactions.”

CMFI is an Internet-based shareholder advocacy organization representing the interests of individual mutual fund investors. More information about CMFI and its activities can be located on its website at www.investorscoalition.com.
