



All that's hot in the mutual fund industry

MoneyVoices: Omnibus Accts Demand Sunshine

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The use of omnibus accounting has been very beneficial to the financial services industry, especially in ensuring the efficient processing of fund transactions. However, the lack of transparency within these intermediary accounts is not serving the interests of mutual fund investors.

Aside from providing a safe haven for arbitrage activity, omnibus accounts prevent funds from being able to apply their prospectus policies and procedures in a uniform manner. Frequent trading policies, breakpoint discounts on sales loads and other important fund actions cannot be processed with precision in these accounts held by third-party intermediaries.

After the market-timing scandals, the Securities and Exchange Commission promulgated Rule 22c-2. This provision sought to provide funds with a regulatory tool to obtain investor identity and transaction information from financial intermediaries. Under this rule, each fund decides when and under what circumstances to request this information.

A review of the prospectus filings of the 50 largest mutual fund complexes reveals that funds are not using this important new regulatory tool. Instead, they prefer to rely on intermediaries to enforce fund policies and procedures on their customers. Funds acknowledge this problem in their prospectus filings. It must be somewhat embarrassing for a fund complex to admit an inability to apply rules and privileges in a uniform manner within these third-party accounts.

Given the competitive and diverse nature of the industry, this problem should be resolved by standardizing the Rule 22c-2 information-sharing process. This can occur in a very cost-effective manner through the networking and other account processing systems of the National Securities Clearing Corporation (NSCC). These systems are used by more than 80% of funds and intermediaries to exchange order and account information. The most inexpensive and effective method for exchanging this information is to do so as orders are placed, or on a "same-day" basis. The technology required to provide this type of full transparency has been around for more than a decade.

A compliance system that provides full transparency within omnibus accounts ensures that promised prospectus policies and procedures can be applied uniformly across all distribution channels. Full transparency can be accomplished quickly, inexpensively, and in a manner that resolves a number of fund regulatory problems, from the collection of redemption fees to the calculation of breakpoint discounts. Investors deserve an improved system in which the policies and privileges that are promised in the prospectus are actually delivered.



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He is also a founding partner of Holch & Erickson LLP. He has more than twenty-five years experience in both private practice and government service in Washington.

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