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INVESTOR GROUP TO BOARDS: LOOK AT COSTS OF OMNIBUSES

Boards should be concerned about up to $9.6 billion per year in unnecessary costs that shareholders are unaware of paying, says Niels Holch, executive director of the Coalition of Mutual Fund Investors. *The Shareholder Costs of Hidden Mutual Fund Accounts*—a white paper recently released by the coalition—highlights an additional expense of $48 per fund account when using these "hidden" or omnibus accounts, which hold the transactions of many different investors of a financial intermediary.

Holch recommends more transparency in disclosures to shareholders of payments to third-party intermediaries, the avoidance of conflicts of interest within

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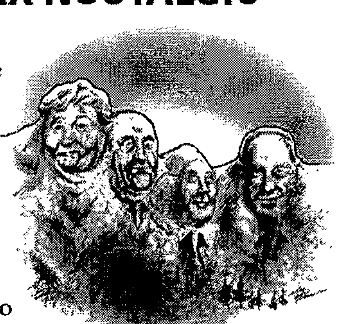
FORMER DIM DIRECTORS WAX NOSTALGIC



Four former Securities and Exchange Commission Division of Investment Management directors came together at the Investment Management Law Conference at Hofstra University to reflect on the most significant changes and challenges of their terms.

"Instead of becoming ever more insistent that a fund can't break the buck we could have let an occasional fund break the buck," Joel Goldberg, who served as division director during the early '80s, said of what he would change. "The market would have adjusted and would have the same

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HOW BOARDS WORK

ALTERNATIVE STRATEGIES SEEN CREEPING INTO BOARDROOM TALKS

Mike Malloy

Boards are now considering funds with hedge fund-like strategies that go beyond the typical long and short positions. Boards are delving into this area with the fund's management—which has been looking into these different types of investments and deciding how best to position the funds, according to Mike Malloy, partner at Drinker Biddle. "This has been building momentum because people are accepting that alternative investments play a role in an organization and in personal investments," Malloy said.

The board of RiverSource funds recently approved an options overlay strategy for its target-date exchange-traded funds that goes beyond simply taking long positions (*FD*, August). More recently, Putnam Investments has expanded its suite of target-date funds to include absolute return strategies to bring more diversification, and the *Turner Spectrum Fund* has been using different long/short equity strategies while investing in a number of different sectors. Although newly minted with these funds, AIP Mutual Funds, which

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ALTERNATIVE STRATEGIES

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was acquired by Hatteras Funds over the summer, has been providing open-end mutual funds of hedge fund strategies since 2002. Malloy noted that the strategies have not been as widely used in the past but more funds may now be thinking of going that route.

These alternative strategies require more analysis and oversight from boards. "If boards are used to being in a long-only environment then it's a new type of investment style being introduced to them," said Malloy. "They have to understand that investment style and analyze the capabilities and experiences of the asset manager."

Stephen Lewis, chairman of the board of RiverSource funds, said the board's first consideration should be how well the strategy has worked over a period of time and in different kinds of markets. Like Malloy, he said it's important to look into the fund manager's record and make sure the manager is experienced in this area. "We are not inclined to let shareholders in the funds be guinea pigs for those that want to try new things," said Lewis.

Also, the board should look to the chief compliance officer and those in risk management to monitor the new strategies and inform the directors on how well it is being executed, Lewis said. "As you get into these kinds of [investments] one wants to know what part of this works, what part didn't work as well as you thought and what are you doing about it," he added.

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the sales and distribution system and ensuring that the prospectus policies and procedures line up uniformly across all distribution channels. "Boards should get more information about these fees, such as what's being offered in return and if it is at a fair price," he added.

"There seems to be a larger cost for someone who is transacting through an intermediary or a third party," said Holch. "The board should be concerned if payments are being made to brokers for activities brokers are already responsible for doing." The paper states that for the omnibus accounts these intermediaries are being paid on average between $19 and $25 for each client position held in a fund, while the estimated cost for shareholders who purchase mutual fund shares directly is $10. The coalition estimates that as many as $200 million accounts are held in omnibuses, according to the paper, not including another roughly $200 million in 401(k) accounts.

"There's been a growing industry trend for these intermediaries to internalize the transfer agent services and indeed earn additional revenues," said Edward Burke Carey, chairman of the board of the Fifth Third Funds. "Some of these costs mentioned are likely at the account and not the fund level." Carey said for his fund the board does not have any control over the account level fee, which could include costs for the printing and mailing of statements as well as other investor services costs.

"What the white paper leaves out is another cost that the platforms take over, which is the fund administration side," said Stephen Little, chairman of the board of the Unified Series Trust. "That cost component that is taken on by the omnibuses is not quantified here at all."

Carey further noted that the agreements funds have with intermediaries are included in fund disclosures but should specify the types of services and related fees that shareholders are receiving. "Omnibus accounts impose different cost arrangements on fund shareholders—sometimes increasing their costs and sometimes lowering their costs," he said. "We disclose these arrangements in our prospectus in general terms because each arrangement is somewhat unique but the industry has to find out how to show these costs."

ICI/IDC Paper Addresses Intermediary Relationships

*The **Investment Company Institute** and the **Independent Directors Council** recently released a white paper on navigating intermediary relationships. The paper outlines questions that may help boards understand the fund's distribution and shareholder servicing systems, the intermediaries' involvement and the associated compensation structure. Potential board questions include:*

- What types of intermediaries sell the fund's shares?
- What is the distribution strategy associated with each of the intermediary partner?
- What services are provided to fund shareholders by each type of intermediary partner?
- How are the intermediaries compensated for their services?
- Do the distributor, advisor, and/or any other party pay any of the intermediaries additional amounts (through revenue sharing payments)?
- If so, what is the purpose of these payments and how are they calculated?

