



All that's hot in the mutual fund industry

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SEC Stepping Up Market-Timing Vigilance

Article published on May 1, 2008

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Securities and Exchange Commission examiners are heightening their focus on market timing, especially with recent market volatility, says Gene Gohlke, associate director of the SEC's Office of Compliance Inspections and Examinations (OCIE).

"We have been asking about [market timing] for years, but now we're paying a little more attention," Gohlke says, adding that attention has increased in the last six months. "We'll spend more time understanding exactly what a fund is doing to monitor shareholder flows and understand a little better how they follow up on situations."

Gohlke's comments follow on comments he made at last week's Practising Law Institute conference, where he urged fund shops to monitor "shareholder flows for unusual patterns that might represent inappropriate market timing."

The heightened focus on market timing comes at a time when the SEC is seeking enforcement action against two UK hedge funds for their role in market timing and late trading in mutual funds. Last month the regulator charged **Headstart Advisers**, its chief investment advisor and its Headstart Fund. That was preceded by charges against **Pentagon Capital Management** and its chief executive.

According to Gohlke, market volatility in the equities market is creating new opportunities for market timing, and fund firms need to be vigilant in attacking the problem even with SEC-enacted safeguards in place.

Niels Holch, executive director of the **Coalition of Mutual Fund Investors**, praises the SEC's enactment of the so-called redemption fee rule, which better enables funds to track market timing. The final phase of Rule 22c-2 took effect in October and requires financial intermediaries to provide fund firms information including shareholder identity and transaction information to empower funds to stop or limit market timing. But the rule in and of itself is not enough, Holch says.

"I think it is great that the SEC is focused more on its examinations of the actual monitoring process," Holch says.

Rule 22c-2 allows funds to spot market timing after the fact while analyzing aggregated data. A real-time approach in which funds could better monitor individual flows is what Holch has long advocated.

His organization conducted a study last year that analyzed prospectuses from the largest 50 mutual funds and found that they were "unable to uniformly enforce their policies because of a lack of transparency in [omnibus] accounts."

"As a result of this problem, all of these large fund groups now disclose in statutory prospectus filings that they have no choice but to consider waiving, excluding, or limiting the enforcement of their short-term trading policies within omnibus accounts," the group wrote in an SEC comment letter.

Having SEC examiners pay close attention to how funds monitor their omnibus accounts sends an important message to the industry, Holch says.

"There is really nothing to monitor except aggregated data, which does not tell you the whole story," Holch says of omnibus accounts. "So I think the SEC is correct to focus on the monitoring procedures."

Gohlke emphasizes that even with redemption fees and other measures in place to reduce market timing, funds "still need to be vigilant and, where appropriate, monitor and look at daily shareholder flows, particularly when there are significant market events," such as large shifts in market prices.

Even with stringent measures to guard against market timing there is no guarantee that someone won't find a way to evade those controls. Gohlke says it helps if a fund group can demonstrate effective monitoring procedures.

"I think that certainly helps a fund... to be able to demonstrate they recognize the issue and implement effectively what they thought were good controls," he says.

Mike Wolensky, partner with **Schiff Harden** and a former SEC enforcement official, says it is not surprising that today's volatility

heightens the agency's concern over market timing. The ability to trade significant amounts in opaque accounts, such as in an omnibus account, draws regulators' attention, he says.

"That is certainly one area where you can see abuse because there could be attempts to hide it in omnibus trading," Wolensky says.

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