

Redemption Fee Rule Countdown: Shareholder Data Challenges

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By Beagan Wilcox

As the deadline approaches for fund firms and their boards to comply with the SEC's redemption fee rule, a challenging question has emerged: How should funds collect shareholder transaction data?

The data includes the frequency of shareholders' trading, which fund groups will use to determine whether shareholders are engaging in abusive market timing of the funds.

Some funds want to use a risk-based model (concentrating on funds more prone to market timing) and others want to use a more blanket approach that covers all funds the same way.

"They want a lot of flexibility in terms of how they're going to deal with a solution," says Chip Miller, executive vice president of Access Data Corp., which collects and analyzes shareholder data for fund firms. "Nobody knows exactly how much data they will have to bring in and manage."

Vendors have grappled with this issue in developing their services. But the question is now one of many that boards are trying to get their arms around.

Under the rule, which aims to thwart market timers, boards must consider whether funds should have redemption fees. As they do so, they are also reviewing the mechanics and costs of the rule. (See our companion story, "Redemption Fee Rule Countdown: Boards Review Costs.") The rule's compliance date is just around the corner: Oct. 16.

The impending deadline has led boards to question what approach is best when it comes to collecting and managing shareholder data. And while many boards are outsourcing the task of collecting shareholder data to comply with the rule, those vendors differ in their approaches between an all-encompassing method and a risk-based one.

PFPC, for example, has embraced the risk-based approach, says Christine Gill, vice president and senior director of the firm's global product management group. Working with Sungard, PFPC has developed tools that allow funds to analyze the data in omnibus accounts and to determine if they need to drill down further, as opposed to looking at detailed transaction activity all the time, says Gill.

For some, this issue is even more important than cost.

“The role of the board, I think, even more than the cost issue, is [to ask], what’s the right level of vigilance on these omnibus accounts?” says JoAnn Strasser, partner at Thompson Hine.

Monitoring omnibus accounts is a major hurdle in complying with the rule. With these accounts, in which individual trade orders are lumped together into a single block order, the trades of individual shareholders are harder to track.

The industry has argued that it needs more time to implement the rule in part because it is difficult to ensure that information on the individual shareholders of omnibus accounts can be obtained and shared with funds.

Determining the information from these accounts that will be collected and analyzed also hinges on cost, says Strasser.

“It’s a cost-benefit analysis,” she says. “The small funds might have hundreds of omnibus accounts just like large funds, but the dollars in those accounts are very small... We don’t get any economies of scale.”

One way to go is for funds to start out with the risk-based approach, for which the cost will be lower, says Access Data’s Miller. However, if directors feel they want to be “more aggressive,” he says, they can increase the amount of data they receive.

The industry has urged the SEC to give it an extension so that it can deal with the numerous challenges the rule presents.

As yet, the SEC has not made its intentions clear, so most firms are not taking any chances, even though they may hope for an extension.

“We will be ready,” says PFPC’s Gill. “We will have our testing completed and be in compliance and be ready to support our clients for that date.”

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