

# San Francisco Chronicle

NORTHERN CALIFORNIA'S LARGEST NEWSPAPER

TUESDAY, JULY 23, 2002

## Offering aid to fund managers

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CHRONICLE STAFF REPORTER

Talk about good timing.

For three years, San Francisco billionaire investor/composer Gordon Getty has been trying to start a company that would help mutual-fund managers facing net redemptions, meaning they have more money going out the door than coming in.

Getty's company, called ReFlow, would buy shares from these funds so the managers wouldn't have to sell stock or borrow money to pay off departing shareholders.

Last week, Getty got a no-action letter from the Securities and Exchange Commission, which allows him to go ahead with his novel concept.

The tacit approval comes at a time when net redemptions are a problem for many funds and the overall market.

In June, investors withdrew \$11.1 billion more from stock funds than they put in, according to AMG Data Services. For the first three weeks of July, net outflows totaled \$18.5 billion, with \$11.4 billion coming in the one week ending July 17.

There is even evidence that investors are pulling money out of stock funds in their 401(k) plans, the last bastion of lethargy.

In June, 401(k) plan participants' allocation to equities fell to 64.9 percent of total balances, according to Hewitt Associates, which tracks the daily activity of 1.5 million participants at large companies. June's allocation to stocks was the lowest since Hewitt began keeping track in 1997.

Most fund managers keep a modest amount of cash on hand to meet redemptions. But if they run out of cash, managers may have to sell stock to pay off shareholders.

Fund managers hate selling to meet redemptions because they're usually selling when prices are falling. They also have to pay brokerage commissions, and a sale creates a taxable event — something tax-efficient funds try to avoid.

Net redemptions can also be a problem for the overall market. When managers sell en masse to meet redemptions, stock prices fall, which encourages more redemptions, creating a vicious downward spiral.

Stocks in the Standard & Poor's 500 index have been hit especially hard this year, in part because index funds keep almost no cash on hand and many have been selling to meet redemptions.

Some fund managers can borrow money from their banks to meet redemptions, but many don't because it makes the fund even more risky. Some funds can borrow money from other funds in the same family to meet redemptions.

ReFlow, which plans to begin operating Sept. 3, will offer funds a new alternative.

It will start out with \$50 million in capital from Getty trusts.

Each day, funds facing net redemptions can try to sell shares to ReFlow. The manager can use money from ReFlow to pay off departing shareholders.

ReFlow will buy shares at the

day's closing price, just like other shareholders. It will collect a fee from the fund for its service.

The fee will be set by a Dutch auction, with each fund stating how much it wants to sell and what fee it's willing to pay. ReFlow will fill all orders it can at the lowest winning fee.

For example, suppose on day one ReFlow has \$50 million to invest. Four funds each want to sell \$10 million worth of shares and are willing to pay 35 basis points (0.35 percentage point). One fund wants to sell \$10 million and will pay 25 basis points.

ReFlow will buy \$10 million worth of shares from each of the five funds. Each fund will pay 25 basis points, or \$25,000. Any fund that bid less than 25 basis points will be out of luck.

As soon as a fund gets more cash — from new shareholders or stock sales — it must buy the shares back from ReFlow, again at the current market price. If the fund has not repurchased the shares within 28 days, ReFlow will redeem them itself.

Funds that use ReFlow won't create a taxable event or have to pay brokerage commissions when they sell to ReFlow.

Alan Reid, president of ReFlow, says the firm plans to make money from the fee, not from market fluctuations. It hopes to hedge fund shares with futures and options to neutralize market gains and losses.

ReFlow will essentially be "a market maker for mutual funds," says Reid, who is also president of Forward Funds, a San Francisco mutual fund company also owned by Getty.

Reid says that ReFlow will do business with bond and money market funds as well as stock funds. Its target market is small fund groups.

Funds will have to get board approval before doing business with ReFlow.

Getty's \$50 million in startup capital won't put a dent in the mutual fund market, but ReFlow is talking with investment banks about putting up additional capital, Reid says.

But first the concept must prove itself.

Mutual-fund consultant Geoff Bobroff is skeptical that funds will find ReFlow an appealing alternative.

"It lets you avoid fire sales," he

says. "But the mechanics are more cumbersome than going to your bank" for a loan.

Bobroff says stock funds have weathered a long, steep decline in the market without suffering severe or prolonged net redemptions.

"Historically, the redemption rate has been under 2 percent of assets. Now, it's over 2 percent, but it's not horrific. We haven't seen a steep spike in redemptions. The primary reason: Over 50 percent of the industry's assets are in retirement plans. Those investors tend to be more buy-and-hold investors," he says.

Although most people have never

heard of ReFlow, some in the industry say it sounds like a neat idea.

"At a time when mutual-fund managers need resources, this is certainly innovative," says AMG President Bob Adler.

Terri Spath, manager of the Franklin Large Cap Growth Fund, says ReFlow's idea "is interesting. I think there's a niche (for it) somewhere."

She says it could help smaller funds manage their risk, but ReFlow itself is taking a risk trying to hedge its positions over such a short time period.

"Trying to hedge on a 28-day time period is very tricky," she says.



# ReFlow

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