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Three Oppenheimer Funds Tap Liquidity Service

by **Hannah Glover**

OppenheimerFunds last week signed up three of its funds for services from ReFlow Management, a company that aims to provide liquidity and tax management help to mutual funds.

The \$528 million Oppenheimer Balanced Fund, the \$1.53 billion Oppenheimer Capital Income Fund and the \$1.43 billion Oppenheimer Core Bond Fund are the latest in the OppenheimerFunds lineup to sign on, according to regulatory filings.

ReFlow's liquidity services help fund companies manage inflows and outflows of assets. The aim is to help portfolio managers "be much more methodical about when and how they put cash to work and when and how they sell securities," says ReFlow president Paul Schaeffer.

ReFlow partners with funds, acquiring up to 3% of the total net assets. In the case of a fund facing redemptions, ReFlow takes the shares in exchange for cash, which is then used to pay out redeeming shareholders. ReFlow then holds the shares for up to 28 days. Managers can essentially buy back the shares by paying ReFlow with incoming cash contributions or securities from the portfolio in-kind.

The benefit of the service to fund managers is that they can avoid selling off portfolio holdings to raise cash to meet redemptions. Such sales can be especially damaging to performance in the current downward market. At the same time, these fire sales are among the only options managers have at a time when securing lines of credit from banks or other institutions — the other most common way for managers to meet cash demands — is increasingly difficult and costly. Also, by avoiding selling portfolio holdings, the service minimizes having to distribute taxable gains.

ReFlow, for its part, collects a fee, typically between 15 and 17 basis points for this service.

Year-to-date, ReFlow says it has provided funds with \$880 million in liquidity. That compares with \$2.2 billion paid out during the five-year span from 2002 to 2007. Much of the new interest comes from fixed-income managers, who can squeeze more alpha from their portfolios if they can hold on to their underlying securities longer, says Schaeffer.

In the first years after ReFlow was founded in 2002, business trickled in for the company, which, at the time, counted affiliate Forward Funds among its biggest clients. By 2006, it had added the Eaton Vance, MetropolitanWest, Aston and Bridgeway fund families to its client roster. Last year, OppenheimerFunds signed up some of its funds, regulatory filings show. This year filings showed a flood of new interest as Utopia Funds and RiverNorth Funds joined. November brought not only the three new Oppenheimer products, but business from the actively managed and lifecycle funds offered by American Independence Funds. Representatives from each OppenheimerFunds and Eaton Vance declined to comment beyond the regulatory filings.

And while the massive outflows that thumped the industry through October and November have highlighted

how damaging sudden calls by investors for huge amounts of cash can be, analysts say that cash management services like those offered by ReFlow can help improve performance and manage taxes in good times and in bad.

“To me it is probably one of the most important innovations in the mutual fund industry,” says Avi Nachmany, EVP and co-founder of Strategic Insight. That is because ReFlow, armed with a no-action letter from the SEC, helps funds keep more of their investors’ dollars invested, rather than keeping cash on the sidelines to meet redemptions. The result can be better performance and a softer taxable gains hit for investors. Performance and expenses are two top-of-mind issues for mutual fund boards, he adds.

The fees collected by ReFlow are far less than the drag on performance investors face when a manager is forced to trade to accommodate flows. In fact, on average, for every \$1 in trading cost forced by flows, the fund value drops by \$0.53 on average, according to research from Virginia Tech professor Gregory Kadlec. By comparison, when a portfolio manager elects to make a trade and is not forced by sudden inflows or redemptions, the fund value rises \$0.22 per each \$1 trading cost.

During periods when cash flows in faster than portfolio managers can invest it, ReFlow provides the liquidity service in reverse, taking in the cash and dispersing it slowly in exchange for shares in the fund or equities the fund would like to dispose of. The slow dispersion of cash helps managers from moving the market price of equities they seek in a rush to place large influxes of cash. While small trades can boost a fund value by \$0.38 per \$1 in trading costs, big, clunky trades depress the value by \$0.88 per \$1 in trading cost, Kadlec’s data shows.

In some cases, that means swapping out shares with a low cost basis for those with a higher cost basis to limit the tax hit to a fund overall. Nachmany sees this service as a way to equalize the tax hit mutual fund investors take when their fellow investors move in or out of a product. The result is giving mutual funds a tax treatment similar to that of their ETF cousins.

And controlling taxes will be another important strategy this year, when poor performance and the expiration of tax-loss carryforwards will deal investors a double blow in 2008 and likely in 2009, says Lipper analyst Tom Roseen. By not being forced to sell at a loss during periods of high demand for redemptions, funds avoid “shredding their current investors,” he says.

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