



GLOBAL FUND SERVICES

Soft-Lock Mechanisms in Omnibus Accounts

**Global Fund Services Technology Working Group
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Contents

1. Summary.....	3
2. Introduction to soft-lock mechanisms.....	3
3. Challenges with CDSC and omnibus accounts.....	4
4. Path to automation.....	4
5. Conclusion	5

1. Summary

This white paper explores the key features of soft-lock mechanisms and the challenges faced in applying them with omnibus investor account structures. It outlines solutions that can be implemented to enable full STP scalability and improve the investor experience.

The proposed solution can already be supported by Clearstream and Euroclear. Euroclear has already confirmed the ability to support this model as their preferred solution to soft-locks. We expect other distributors to follow.

2. Introduction to soft-lock mechanisms

A soft-lock refers to a designated period defined in the fund prospectus, during which an investor in a fund is discouraged from redeeming their investments early. Unlike a hard-lock, which completely restricts withdrawals from a set period, a soft-lock allows for withdrawals, but imposes a fee within a specific period.

A prevalent soft-lock strategy employed by asset managers is to apply Contingent Deferred Sales Charges ("CDSC"). Under a CDSC structure, an investor who redeems shares within a designated period incurs a penalty fee, which decreases as the holding period progresses. These redemption fees are typically a percentage of the redemption amount. The fee starts at a high percentage (for example, 3% in the first year) and gradually declines (e.g. 2%, in the second year, and 1% in the third year) until it disappears entirely after the soft-lock holding period expires, as per the illustration below.

Investments held up to 1 year	Over 1 and up to 2 years	Over 2 and up to 3 years	Over 3 years
Redemption fee of 3%	Redemption fee of 2%	Redemption fee of 1%	No redemption fee

Illustration 1

Within CDSC structures, the FIFO ("First in, First Out") accounting method is commonly used to determine which shares are subject to the fees when an investor decides to redeem them. Under FIFO the shares purchased first will be redeemed first and the redemption penalties will be calculated based on the deferred charge for those earliest purchased shares.

3. Challenges with CDSC and omnibus accounts

Asset managers typically use platforms to distribute their funds. Most of these distribution platforms use omnibus accounts when placing orders with the fund's transfer agent (TA). However, the use of omnibus structures eliminates the tracking of the respective subscriptions on the TA account. In a soft-lock scenario, the investor must be linked to the holding period of the shares being redeemed to apply the appropriate fee. Since the omnibus account comingles multiple investors coming in on multiple subscription days, it is not possible to apply the correct redemption fee per investor as they are all comingled.

Instances have been observed where asset managers have attempted to apply series accounting to circumvent this issue to track investments within omnibus accounts. This approach is however cumbersome, given the administrative overhead, complexity and risk for distribution platforms, asset managers and TA's. More importantly the fact that it totally breaks the Straight Through Processing ("STP") of investor transactions, which is one of the main objectives with distributing liquid-alts products through platforms, and it adversely impacts the investor experience and can hamper distribution. Series accounting is a concept taken from performance fee tracking where fees crystallize typically annual which is a different use case and should not be seen as the solution to soft-locks on omnibus accounts.

4. Path to automation

The solution below shows how asset managers, TA's and distribution platforms can enable full STP scalability and improve the investor experience.

Solution: distribution platforms to open segregated investor accounts at the TA, utilizing API technology

Distribution platforms can open segregated accounts for each investor or dealing date.

Segregated accounts per investor offer the most granularity and would be required for funds which include provisions for redemption gating at the investor level.

Segregated accounts per dealing date are less granular but would be required where the look through to the underlying investor is not available.

In either model, instead of operating a single omnibus account, each investor or subscription dealing date is assigned a unique investor account, allowing for transparent tracking of soft locks and the use of fully



automated CDSC calculations within the core TA applications. API investor account opening technology between the TA and the platform can be used to open such segregated accounts at scale. For example, see the scenario below as per CDSC structure outlined earlier in illustration 1.

Account A1

- Dealing Date: March 1, 2024.
- Subscription: 500 shares.
- Age (on April 1, 2025): 1 year and 1 month, so 2% fee applies at redemption.

Account A2

- Dealing date: December 1, 2024.
- Subscription: 500 shares.
- Age on (on April 1, 2025): 4 months, so 3% fee applies at redemption.

Opening segregated accounts facilitates lot tracking at the TA and distribution platform level enabling full STP scalability offers the following:

- Investors benefit from a streamlined and automated account openings process that makes it faster and easier to invest, improving the overall investment experience.
- Platforms benefit from full STP scalability, which reduces the cost and risk of manual account opening, redemption fee tracking and transaction processing.
- For TA's, automating account opening through APIs and providing STP (in funds that impose soft-lock periods) brings operational efficiency, risk reduction and scalability.

5. Conclusion

Distribution of funds with soft lock mechanisms through platforms can be achieved with the right technology. The API Investor Account technology can enable scalable distribution and improve the investor experience, whilst protecting the fund with the soft-locks.