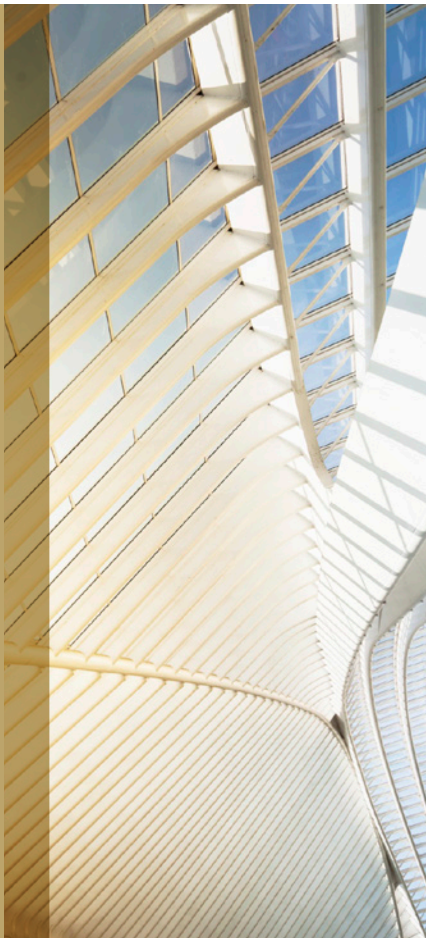

It's Not Your Parent's Transfer Agency: Responding to Changing Dynamics within the Mutual Funds Industry

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The business of mutual fund transfer agency is evolving. Over the last decade, this evolution was evident as mutual funds and their transfer agents responded to challenges presented by innovations in shareholder servicing models. While recordkeeping continues to be the primary function of mutual fund transfer agents, new responsibilities are emerging that require new tools and skillsets.

One of the principal trends driving this evolution is the way that investors purchase mutual funds. Investors have shifted from purchasing mutual funds directly from the fund company to seeking advice from a financial advisor or purchasing mutual fund shares through a platform program. From 2005 through 2014, the number of mutual fund positions that were held by "direct to fund" shareholders (where the shareholder places trades directly with the mutual fund) declined by 31%, despite an approximate 16% increase in the total number of shareholder accounts[1].

The second trend that has had a dramatic impact on the industry is the accelerated growth of broker-dealers' and other intermediaries' use of omnibus account relationships with mutual funds. In an omnibus relationship, the intermediary performs shareholder servicing and transfer agent-like duties and maintains a single "omnibus" account on the books of the fund representing the aggregate of all the shares owned by that intermediary's customers. In many cases, the intermediary is considered to be an agent of the fund, and assumes shareholder servicing responsibilities on behalf of the fund, often for a fee. The number of shareholder account positions held in omnibus accounts has ballooned from about 80 million positions in 2005 to approximately 211 million positions in 2014[2].

The result of these two developments is that fewer shareholders are serviced directly by mutual fund transfer agents, and more shareholders are serviced by the various intermediaries that distribute the funds to the public. The intermediary's customers are relatively anonymous to the asset manager (although information may be available for sales tracking and regulatory compliance purposes). Therefore, the information that mutual fund manager possess about their retail customers is becoming increasingly limited and is more widely dispersed among multiple shareholder servicing entities.

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This transition of shareholder records being centrally available at the transfer agent to being held away and thereby less transparently by a group of omnibus intermediaries presents many challenges to the mutual fund company. Perhaps chief among these challenges, particularly in cases where omnibus intermediaries are performing shareholder servicing on behalf of a mutual fund, is that while the shareholder records and shareholder servicing models are dispersed, many of the obligations to comply with applicable federal and state regulations and the terms of the fund's prospectus remain with the mutual fund. In order to satisfy their own compliance obligations, funds must develop and operate omnibus intermediary oversight programs.

There are no regulatory standards for the measures that mutual funds are expected to include in their intermediary oversight programs and a common industry practice has yet to emerge. As a consequence, mutual funds are left to design programs that are tailored to their particular needs and risk appetites. Some measures are less aggressive, such as accepting written assurances from an intermediary that the intermediary is complying with applicable regulations and fund policies. Other measures are more aggressive, such as a mutual fund company conducting an on-site due diligence meeting at the intermediary's offices. Another oversight tool that is gaining popularity is the Financial Intermediary Controls and Compliance Assessment (FICCA) report. Intermediaries are increasingly engaging audit firms to conduct a FICCA assessment, and to provide a copy of the auditor's FICCA report to the asset manager. These and other methods of conducting intermediary oversight are used by mutual funds to oversee each intermediary distributing their funds based on the size and type of relationship, the perceived risk and competency of the intermediary, and other contractual considerations. Mutual funds might often feel as if they have limited flexibility to insist upon more aggressive oversight tools due to concerns that the intermediary with whom the mutual fund is negotiating will deem the oversight too cumbersome and burdensome to support.

The rise of the omnibus model has caused mutual fund transfer agents to experience decreasing volumes of shareholder accounts on their recordkeeping platforms. However, they are now in a position to help both the intermediaries and the funds address the transparency issues that have surfaced as a result of the emergence of omnibus intermediary relationships. Some transfer agents also provide subaccounting recordkeeping services that sort and aggregate the intermediary's daily trading activity for all of the intermediary's customers into a single omnibus account trade. This service incorporates complex computer systems and often includes operational and reconciliation support. Transfer agents can also assist mutual funds by leveraging their knowledge of shareholder servicing regulations and prospectus compliance to provide intermediary oversight program services. These services not only benefit mutual funds, but also intermediaries because the service provider can centrally conduct oversight measures for a number of mutual funds rather than each mutual fund conducting oversight separately. By centrally conducting such oversight, the service provider enhances the efficiency of the oversight process for both mutual funds and intermediaries.

In order to take advantage of the opportunities presented by the omnibus intermediary model, mutual fund transfer agents must embrace change. Due to decreased retail account volumes, there is a need to de-emphasize the mailroom and data entry functions, although these will continue to be important to support shareholders that are not transitioning to intermediated relationships. For transfer agents that are providing subaccounting services to intermediaries, significant investments are required for efficient computer systems and a greater emphasis on complex reconciliation processes. Transfer agents that are developing intermediary oversight program services need to invest in staff with skillsets that will allow them to receive and analyze information provided by intermediaries, and report the results of their analyses to their mutual fund clients. No, it's no longer your parent's transfer agency, but new opportunities are here and more are emerging on the horizon.

Charles S. Hawkins is a Vice President in the Transfer Agent Regulatory Management Department at BNY Mellon's asset servicing group which is responsible for coordinating the delivery of regulatory services to transfer agency clients. Mr. Hawkins's responsibilities include the design and implementation of compliance solutions for new or amended regulations. Mr. Hawkins's views do not constitute legal advice. Participants are encouraged to consult their own legal advisors on legal matters mentioned herein.

1,2 Broker Proprietary, DTCC annual reports, SuRPAS, DST analyst calls/transcripts, ICI Fact Book, and historical year over year growth rates for future estimates.

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