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Emerging Trends in the Global Transfer Agency Market

Foreword

The Transfer Agency (TA) business is in a point of inflexion and practitioners have a dichotomous view of this industry: “Is the glass half-full or is it half-empty?”.

At Oracle, we strongly believe that the Fund Services industry has reached a maturity point wherein TA is an indispensable and critical function, while fund managers shop for services from fund administrators. Fund managers and distributors are increasingly becoming conscious of the fact that the TA element is very critical to leave a positive impact with the fund’s investors. Given this, fund managers and distributors are demanding full-fledged TA capabilities to address their record-keeping needs across the product spectrum, which they offer either on a regional or on a global basis.

The investment management industry is getting increasingly complex by the day. Factors contributing to this growing complexity are new consumer regulations, changes in the regulatory framework and legal constraints. At the same time, new transactions and data flows, diverse cash and security settlement modes, different transaction cycles and the emergence of new and more sophisticated products, particularly in the alternate space, have created additional challenges in managing TA services.

While upgrading existing legacy systems was a viable option for most fund managers thus far, they cannot continue doing so for the next decade.

On the positive side, however, with these challenges, come under-tapped opportunities for TA providers. Given the options and choices made available by technology, we see the emerging picture as follows:

- a) TA service providers have an opportunity to consolidate their multitude of legacy platforms and enable regional and global processing models across the full spectrum of products offered by fund managers, including alternatives.
- b) TA service providers will be able to migrate up the value chain by addressing the demands of customers beyond fund managers, including distributors.
- c) TA service providers will also be able to gain unprecedented operational efficiency by leveraging next generation TA platforms while servicing their customers, thus making a positive difference to their top and bottom lines.
- d) TA Service providers can offer institutional and retail TA capabilities to address cross-border and domestic funds.

The next generation TA platforms underpinned by newer technology will enable global and regional operating models to drive efficiency, consistency and higher standards of service, thus retaining customers who would otherwise have moved to a BPO provider.

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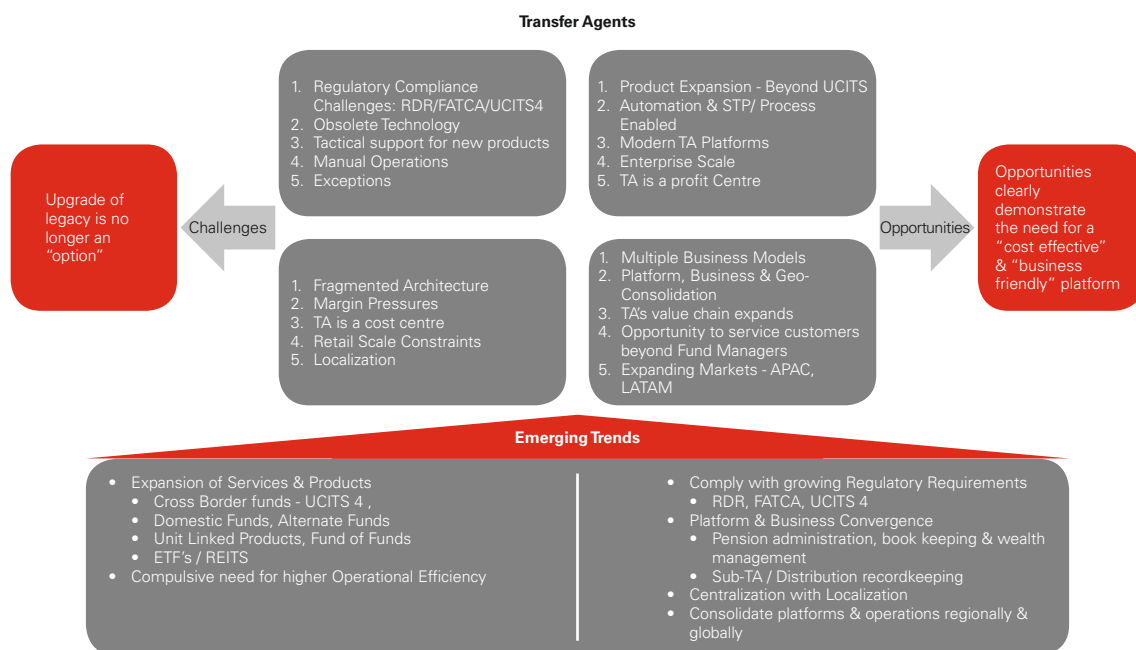
Evolution of Transfer Agency

The Transfer Agency (TA) business has traditionally existed as a support function to the business strategies of the investment management industry, primarily the retail distribution of mutual funds and the institutional business. The basic objectives in supporting the business strategy are to enable a single source of truth with respect to a fund's book of holdings and to provide operational efficiency and flexibility to investors.

The diagram below illustrates the different emerging trends impacting the TA market and the emerging opportunities and challenges.

Expanding Horizon for Transfer Agents:

Cross Border Services and Convergence of Platforms.....



Under Exploited Opportunities

Single Source of Truth

The position of TA in the value chain will continue to change, and the TA service providers have an opportunity to move further forward to support the other entities including distributors. With the convergence of administrative needs across long-only funds spanning cross border and domestic funds, alternative products, unit-linked products and many others, administrators are facing a clear and critical necessity to review their current IT strategy & platforms to provide a single source of truth embracing all TA capabilities from current diverse platforms to supporting both regional and global processing models, and away from country or fund-specific deployments.

Cost is important for both TA and Fund Managers. TA's are seeking gains through productivity, removing redundancy, and also building on operational efficiency in related operations.

Demand for Customized Solutions

As the financial services industry becomes more complex, the ability to offer more customized solutions becomes more critical.

Flexible data elements, customized reporting, web reporting are all surfacing on top of the list as indispensable functionalities to be offered to clients and distributors.

Eradication of Manual Processes

In an attempt to address the complex operational efficiency, eradicating manual processes is often cited as a means of increasing efficiency, while at the same time, eliminating costly human errors. One aspect of automation lies on the communication front where, in the TA space, it is dominated by fax, mainly for products distributed outside Europe. Electronic messaging initiatives (utilizing SWIFT standards such as MT or ISO 20022) or specialist providers and the improvement of workflow automation are yet to be capitalized on.

Business Growth Enabler

Key business drivers like providing a platform which enables wider product coverage and business scalability, better quality in service and reduced "time to market" continue to be distinct areas of opportunities for TA.

To date, there has been little efficiency in copying "best practices" between different geographical markets and in delivering true capability to service the full suite of complex products e.g. retail, institutional, traditional and alternative.

Customer Reporting/Services:

- a. Single view of holding
- b. Self service
- c. Report on demand and access through Fund managers application or a device

Regulatory Challenges

The current regulatory onslaught has multi-level impacts to TA.

- (1) Firstly, there is a high cost of upgrading systems and redesigning processes. Such priority takes the focus and effort from other revenue generating or cost reduction initiatives like new product development.

- (2) In certain countries, the trend in banning financial advisers from taking commissions from fund managers in exchange for recommending their products to clients is having an impact on TA and the servicing of it.
- (3) Other legislative changes like FATCA and UCITS 4, 5 & 6 continue to place a burden on TA providers and investments managers, as systems and processes need constant updating and refreshing to keep up to date with the ever-changing legislation requirements.

This combined with the nuances of local regulations in each market, whether for offshore or onshore funds, can impact global players by imposing high costs for compliance from market to market. This becomes a scale game and flexible systems and operating models are then a must.

New Markets/Opportunities

New Markets /Opportunities – Global & APAC Markets Coverage

Asia

There is a strong focus on Asia at the moment with large economic growth rates and even though it changes from country to country, the political environment is more stable for the region including the emerging markets.

Stable economic fundamentals are also observed with regular savings by residents. As the economy begins to recover, there is now a shift of investment away from the low-yielding deposits to securities and managed funds. Opportunities for these have expanded with the allowance for multiple currencies for fund management companies to provide offerings in order to encourage unit trust funds to be distributed overseas. Having said that, there is still a trend towards investing in offshore funds.

Business infrastructures are in place and this includes IT, telecommunications, transportation, employee safety and banking infrastructure.

There are, however, some key challenges for TA providers in this region, they are as follows:

- (1) Obsolete systems and high maintenance cost for local vendors performing TA in-house;
- (2) Lack of well proven system solutions by service providers to meet local unconventional regulations; and
- (3) Cost efficiencies – many mature Asian markets including Japan and Singapore have low level of automation unlike their counterparts in Europe, who use various automation messaging systems, all of which are trying to penetrate the Asia market.

A positive factor in Asia which can be and is leveraged for TA global operations is the low-cost labor market. This factor can create a high concentration of expertise TA knowledge in countries like India, and can influence the “centers of excellence” set-up in these markets.

The situation in Asia is that there is a distinct lack of local knowledge for the providers who have their roots outside Asia. The lack of a deep and unified understanding of these fragmented markets, along with

the language barrier and constraints such as legislative requirements, makes it difficult for TA providers to offer a truly regional service model. Therefore, for regional players in Asia, the result of this is the utilization of a mix of TA providers, or in an in-sourcing and outsourcing model.

The mix of cross border funds and domestic funds varies by country. Markets such as India, China, Malaysia, Vietnam, Philippines, etc., only focus on domestic funds, whilst more open markets such as Singapore and Hong Kong have a high degree of cross border funds.

The Hong Kong fund market is dominated by foreign-domiciled funds. Locally domiciled funds make up just 10% of funds registered in Hong Kong. Luxembourg-domiciled funds still dominate the Hong Kong market but their dominance has gradually been decreasing since 2007. Although Taiwan has a vibrant fund market, with more than half of funds registered for sale being cross border, there is the restriction that all cross border fund institutions must appoint a single master agent to represent it in Taiwan.

China is a protected and highly regulated market, largely driven by government policy. Banks are the main distribution channel and short term trading is the norm with long term investment slowly gaining traction. If restrictions and regulations are relaxed, then there will be an untapped market for outsourcing.

New Zealand is a small open market with regular contributions of Superannuation for residents and employers. However, the government halved the minimum contribution to 2% and set the compulsory employer contribution to 2%, so the growth of FUM is expected to slow.

Malaysia is forecast to triple its assets under management from the current levels to reach RM 1.6 trillion (515 Billion USD) by 2020, and is a market that tends to favor outsourcing TA functions. The Malaysian government has introduced the use of multiple-currency trading to encourage the distribution of unit trust funds overseas. The recent relaxing of regulations for Shariah funds has encouraged growth in this sector.

The value of a regional passport scheme in Asia is recognized and regulators are progressing development of the concept. However, there are many obstacles to be overcome for this to become a reality. For example, the tax regimes for countries are complex and varied. In the meantime, approximately 40% of UCITS fund sales were from Asia in recent years.

The population in Asia is predicted to increase significantly. The number of families becoming middle class and, therefore, potential investors is to increase significantly. The GDP in Asia is predicted to grow significantly. All of this would suggest a significant increase in FUM, add to that historically closed markets are gradually relaxing regulations. This has got to represent a window of opportunity open for TA's to embark on building revenue models.

LATAM

Much like Asia, Latin America is showing large opportunities for growth. During the global downturn LATAM benefited from healthy consumer demand, so is now well-positioned to benefit from a global

recovery. Countries thought to represent investment opportunities are Brazil, Mexico, Chile, Peru, Columbia and Panama.

However, in saying that, key concerns people have about investing in LATAM are complexities of tax and regulation, potential political and economic instability and currency fluctuation. Recent cases of anti money laundering and the breakdown of KYC processes in foreign financial institutions in LATAM are evidence of change and it is thought that within 3 to 5 years the key LATAM countries will have transitioned to international financial reporting standards.

Russia

Russia's small mutual fund management industry faces the challenge that local bank deposit rates, which can be between 9% and 11% provide investors a sound alternative. Russia's domestic fund market is not growing and represents approximately 0.25% of its GDP.

EU and North America

These markets are well-established and the issues at play here are vastly different, requiring a separate white paper.

Technology Platforms

Facing the opportunities and challenges in Asia described above, the TA technology platform must be able to satisfactorily address the majority of, if not all of the areas currently encountered by administrators in the region.

Business

- Diverse business model and product structures
- Faster time-to-market
- Support multi-tiered distributor and intermediary compensation modeling with rules without writing new code
- Refocus of management time on growing business and the need to have an infrastructure platform that supports this
- Ability to accurately reflect AUM
- Distribution hierarchy
- Flexible set-up and definitions of internal and external funds
- Fees and intermediary management
- Discuss how TA's can contribute to business value

Operations

- Lower “cost per unit”
- Enabled to be truly multi x product, x country, x currency, x lingual
- Extend to address the evolving value chain
- Support convergence and consolidation of services
- Searching for lower labor cost vs. automation?
- Time zone management
- Interfacing to upstream and downstream systems (i.e. fund accounting, reconciliation)
- Challenge in finding good people
- Enabling Investor self-service

Technology

- Takeout multi-instance processing
- Better insight with analytical capability
- Controls embedded: integrated workflow & imaging
- Integration into broader technology strategy of organizations
- Need headroom to scale on business growth

Technology is an enabler for improved operational efficiency and delivery of business outcomes Top 10 Aspirations for TA Platforms

What Will Tomorrow’s TA Platform Look Like?

Regulations continue to evolve and/or expand both at a regional and country-specific level, which necessitates continual evolution of existing monitoring and reporting functionality.

1. Time to Market

Products are increasing in complexity. Capturing the market trend and launching products at the right time to optimize profitability has always been a challenge in the fund industry. TA operators have continually been facing this challenge and will continue to do so.

2. Increased Efficiency

The constant challenge to eliminate manual processes in order to increase productivity efficiency and reduce risk is pushing TA operators to reach for implementation of end-to-end automated processing to reduce risk and increase productivity.

3. Higher Standards of Customer Service

As the demands from clients are increasing, and becoming more complex, TA operators will face the pressure to improve their service standards to allow 24*7 accessibility and, more importantly, being available anytime, anywhere and in any form. Channels and devices are going to play a huge role in servicing customers, distributors and fund managers.

4. Handling of Projected Processing Volume Changes with Available Solutions

The systems employed must be sufficiently flexible to handle both the product type and volume requirements. This presents additional challenges to older mainframe-centric systems, since they inherently lack the flexibility to:

- (a) scale to accommodate changing volume demands,
- (b) support new product introductions in a timely manner, and
- (c) enable comprehensive data model and business services.

5. Distributor Commission Structures

Distributors' remuneration models form a fundamental feature in any TA platform. The ability to cope with the ever-changing and evolving structures to remunerate the distribution channel, including the evolving commission payment regulations, treatment of commission/unbundling of advisory fees, will continue to dominate TA operators.

6. Supporting Multiple Business Models

The availability and/or appropriateness of solutions that support multiple business models within a single instance/configuration, or separate instances by product, geography and/or organizational unit would be a critical feature of a future-proof TA platform.

7. Ability to Support Multi-Regional Capabilities

TA platforms must satisfy multi-lingual, multi-currency, multi-time zone, multi-entity, multi-product and multi-structure servicing requirements. These market demands necessitate the application either adopting a "follow-the-sun" servicing strategy or the deploying local servicing centers

8. Data Accessibility

The TA platform will have to ensure that the investment manager, distributor and end investor each has access to their desired information at their convenience delivered over their selected communications protocol.

9. Reporting Access

Operations groups, investment managers, distributors and investors each have discrete informational requirements, but each party ‘wants its data’ through dynamic and real-time reporting access. This would give rise to the adoption of data warehouses/repositories to facilitate the myriad reporting requirements.

Conclusion

- At its core, the TA solution must be able to support both the investment manager and the intermediary/distributor business models.
- Core TA platforms must be able to support real-time interfaces with an expanding range of best-of-breed third party solutions using modern protocols and messaging standards. Until available platforms support the full suite of TA functionality needs, each core platform must be able to talk with accompanying best-of-breed solutions.
- The rapid expansion in the number of products, distributors and markets demand automated end-to-end processing.
- Regardless of the number of physical locations operated by the investment manager or distributor, the core and/or surround TA solution must be able to offer a holistic view of the data of interest (i.e. products, holdings, geographic activity) over as many portals as required in order to adequately support the needs of the client base.
- Data warehouses/repositories will be critical to support global portal accessibility and inter-domicile data and reporting dependencies.
- Increased platform extensibility will enable clients to incorporate enhancements without the involvement of the platform provider. Client-configured data presentation formats for both fund managers and distributors will be facilitated.

Moreover, the application of activity based models will enable common, function-based processes and, therefore, greater efficiencies.

The Author

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Morse is a niche Asia Pacific management consulting and implementation firm. The business was established in April 2005, with offices in Sydney, Melbourne, Hong Kong and Singapore and covering China, Taiwan, Malaysia, Thailand and the Philippines.

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