

Shareholder Recordkeeping



The Feasibility of Omnibus Accounting

Presented by:

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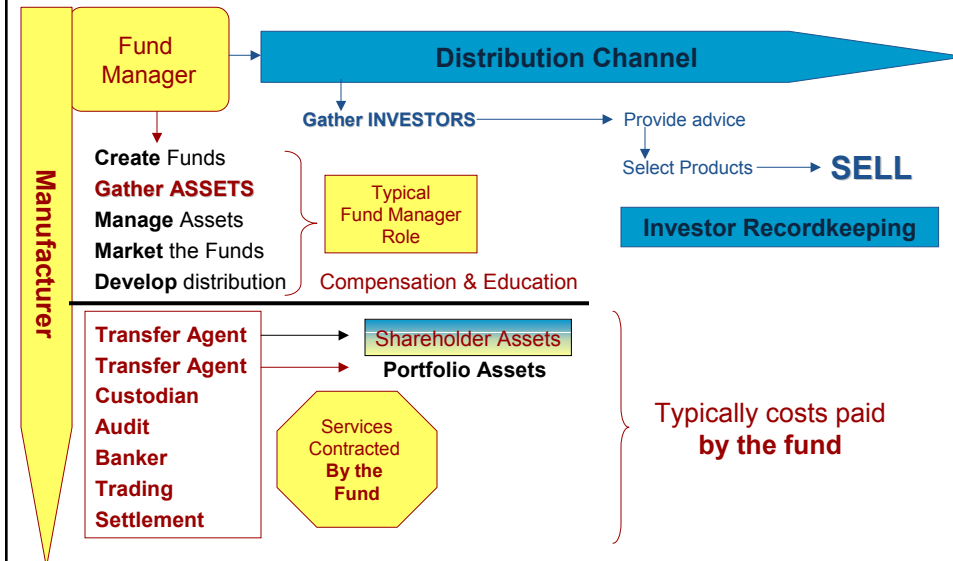


Agenda

- Introduction
- Business Model
- Background and study audit
- Scope & Assumptions
- The US model
- Situational Analysis
- Opportunities
- Feasibility and Key Success Factors
- Options and Recommendations



Business Model



Background and Study Audit

- Canadian industry has experience with Omnibus Accounting
- 2000% growth in mutual funds since 1987
- Approximately 50-60% of business is in nominee accounts
- 6 Brokerage Firms
- 8 Fund Managers
- 6 Service Providers
- 3 Regulatory organizations
- Proprietary research on Wealth Management, research publications from PwC, Tower Group, Datamonitor, Meta Group, Deloitte Research, Federal Reserve Bank,
- Over 45 individuals participated



Scope

To assess:

- The feasibility of migrating the detailed functions of Shareholder Recordkeeping (Transfer Agency) from mutual fund managers into Brokerage Operations (Sub-TA)
- The industry's concerns and issues
- The administrative impact on brokerage firms, fund managers and investors (process)
- Regulatory impediments
- The comparability of the US Model
- Technological implications
- Provide options and recommendations



Assumptions

- Include all mutual fund products, except Segregated Funds
- For participating IDA member firms
- A technology platform will be needed
- A neutral or minimal effect on MER



Situational Analysis

We asked the participants about

- Strategy (why do this?)
- Regulations
- Investor Impact
- MER Impact
- Critical mass
- Information Management
- Operational Risks
- Technology

Overcoming the perceptions
of the obstacles



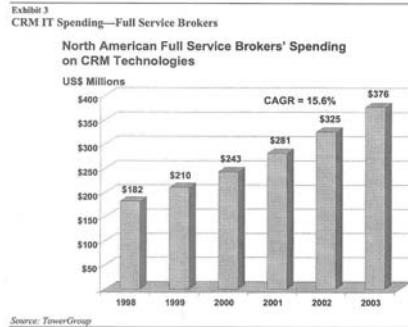
The U.S. Model

- Observed: MFS, Putnam and Edward Jones
- Most impressive takeaways
 - They make it look so simple
 - Effective processes and controls
 - Customer interest is at the centre of the model
 - Motivated by cost recovery and improvements in service to clients
 - Improved relationships with product manufacturers
 - Developed an equitable financial model
- US Regulators' comments

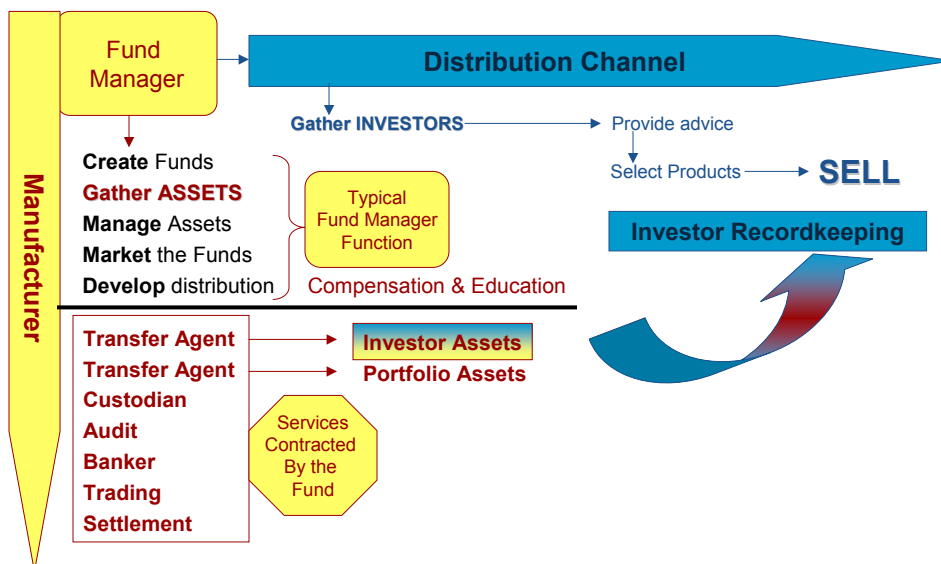


Strategy – Why do this?

- Investment in Wealth Management Strategy by bank owned full service brokerage firms
- Continuing growth in mutual funds investing
- The potential Business Model represents a fundamental shift to the structure, roles and responsibilities in the industry



Business Model





Regulations

Requirements

- Trade Monitoring
- Explicit processes
- Role of FundSERV
- Distribution and/or concentration of Risk
- Details of the system that would support the capability
- The Financial Model
- Disclosure requirements under NI 81-101

Confirmed

- OSC acknowledges non-existent regulations for shareholder recordkeeping processes and/or selection of service provider
- Fees for services – not under the mandate of NI 81-105
- NI 51-101 acknowledges that a registered holder of a security may be an intermediary
- NI 81-102 requires fund managers to make full disclosure of fund expenses
- IDA Rule Book



Investor Impact

How migrating Sub-TA aligns with on-going Mutual Fund industry reform:

- Industry best practices
- Standardization of processes
- Enhanced fund governance
- Streamlined reporting
- Simplifies disclosure to investors



MER Impact

- MER is reflected in basis points
- Substantial range in administrative components in the MERs
- Transfer Agency Operations vary with fund managers
- Most of Top 7 Fund Managers have their TA Operations in-house
- Transfer Agency costs will need to be disclosed
- Different ways in which expenses are allocated
- 30% - 35% of the Admin expenses will not disappear when recordkeeping is migrated (i.e.: legal, audit, fund & trust accounting)
- Striking the right balance will require effective negotiation
- Precedents may be irrelevant



Information Management

Fund Managers need to get

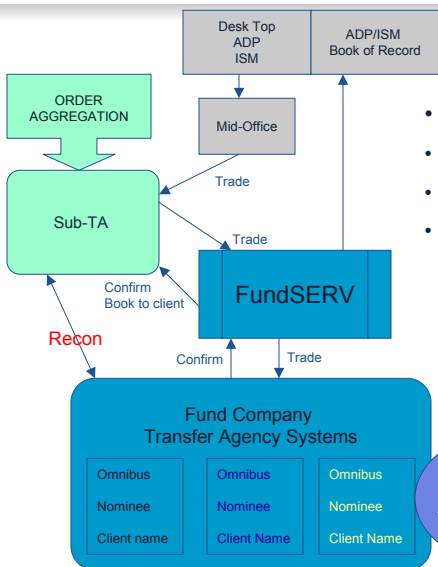
- Sales volumes by reps
- Client transfer data
- DSC calculations
- Reconciliations
- Sales Commissions
- Market Timing
- Short Term trading
- Collection of trading penalties
- Financial accounting data

Brokers need to get

- Trailer fees
- NAVs
- Tax Factors
- Reconciliations
- Confirms & settlement
- Distributions
- Money Market Interest Accruals
- Cost base pricing



Processing Model

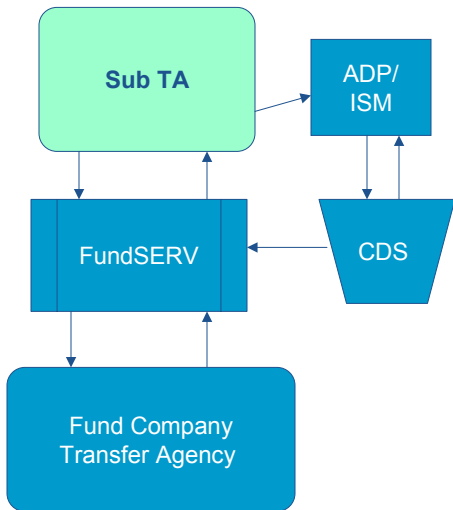


Trade Aggregation Process

- Sub TA system will aggregate orders
- FundSERV receives net result as a buy/sell order
- Order confirmation is returned from Fund Sub-TA
- Settled and posted on T+3



Processing Model



Posting Financial Transactions

Generated by Brokerage Operations

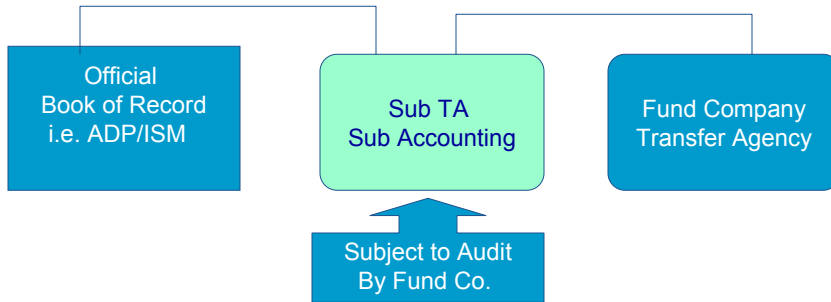
- DSC Fees collected
- Aging of transactions
- Short Term Trading fees
- Detailed buys and sells
- Transfers

Generated by Fund TA

- Money Market Accruals
- Distributions
- Tax factors
- NAV



Reconciliation Model



Operational Risk

Operational Risk

- People
- Processes
- Systems
- External Factors

PLAN, PLAN, PLAN
Identify, assess, control, mitigate, manage

- Financial Risk (*Opportunity*)
 - Predictable ROI from administrative
- Reputational Risk (*Opportunity*)
 - Transfer Agency expertise
- Investor Risk (*Uncertainty*)
 - Complaints
- Strategic Risk (*Uncertainty*)
 - Corporate direction

BENEFITS & OPPORTUNITIES

- Standardization
- Risk Sharing
- Cost Reduction
- Organizational Effectiveness
- Information Management
- Privacy
- Regulatory streamlining



Technology

- Mission critical
- Opportunity to innovate and automate
 - *Rapid product and services implementation*
 - *Easily configurable and re-usable*
 - *Aggregator and consolidator*
 - *Rules engines*
- Leap of faith
- Customer centric – NOT product centric
- Biggest issues:
 - *current technology processes AND architecture*



Opportunities

- Service improvements
- Organizational effectiveness
- Standardization and consistency
- Regulatory streamlining
- Cost reduction
- Information management
- Technological improvement
- Economies of scale
- Transfer Agency consolidation
- Risk Sharing



Feasibility

Key Success Factors

- Overcome industry challenges
- Ability to manage activity to the satisfaction of auditors
- Ability to manage processes
- Ability to manage costs
- Ability to manage an exchange
- Maintain level of acceptability
- Ability to maintain documentation
- Ability to achieve critical path with positive impact



Options

Business Model

- Create a utility for TA rules management
- Outsource the TA function with tested functionality
- Manage TA processes in-house

Transition Model

- Establish a Sub-Accounting Fee for nominee positions
- Convert no-load funds
- Convert front end loads funds
- Convert proprietary funds first



Options

Technology Model

- Existing TA technology provider
- Existing proprietary platform
- “Leap of Faith”
 - New platform
 - Utility

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Financial Model

- Determine basis for contractual compensation from fund manager
 - Fixed fee per position
 - By ‘client’ account
 - On basis points
 - By transaction
- Assess trailer fee structure

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Recommendations

To go the next level:

1. Industry buy-in to the critical models
 - Business
 - Financial
 - Process
3. Identify critical mass
4. In-depth assessment of technology options
5. Internal feasibility assessments
6. Information management
7. Determine focus for standardization

Critical for success:

1. Establish accurate cost elements
2. Involve Regulators in on-going discussions
3. Develop a contractual agreement
4. Determine a transition model

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Conclusions

1. **With the appropriate selection of choices and decisions, a plan to proceed could be developed by Q1 2005**
2. **A utility providing rules based technology could be the innovation for most effective brokerage operations for Mutual Funds Sub-Accounting**

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Closing and Discussion

Thank you



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