

Achieving Transparency Among Financial Intermediaries

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According to Investment Company Institute (ICI) data, shareholders are twice as likely to use a financial advisor instead of investing through the direct marketing channel.¹ This increase in the use of financial intermediaries has contributed to a profound shift away from the traditional shareholder servicing model.

While the use of intermediaries has clearly had a positive effect by increasing fund distribution, the simultaneous use of omnibus accounting has decreased shareholder transparency. As these trends continue, sub-accounting and the use of an omnibus environment will continue apace. This will require fund companies and chief compliance officers (CCOs) to find cost-effective solutions to solve fiduciary challenges inherent in this lack of transparency.

Regulatory Impact

New regulations and changes to existing regulations are broadening protections for the investors and creating additional responsibilities for the fund management company. Securities and Exchange Commission (SEC) Rules 22c-2 (governing market timing and late trading), 2a-7 (setting requirements on shareholder liquidity in money market funds) and 204-2 (commonly called “pay to play”) now give fund companies the responsibility to monitor activity in the omnibus account. These regulations are examples of protections that require the fund to monitor specific and defined existing exposures in the omnibus positions while also identifying unidentified future or potential exposures.

The resulting task for fund companies is to understand shareholder activity in the omnibus account and ensure prospectus compliance. While SEC Rule 38a-1 does not specifically identify financial intermediaries as service providers subject to monitoring by fund company CCOs, these intermediaries are increasingly performing the role of the transfer agent. As such, their oversight by the fund companies for whom they distribute product is an arguable necessity. Intermediaries also receive a large share of servicing fees, further bringing their activities into the spotlight.

The Drive for Transparency

In response to this intensified regulatory requirement, fund companies are stepping up their interaction with financial intermediaries. Alongside periodic due diligence visits, compliance teams are developing risk-ranking methodologies that help identify areas of exposure. In order to better understand shareholder activity, fund companies are also negotiating data sharing arrangements with financial intermediaries on their sub-account level data.

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¹ Investment Company Institute, *Profile of Mutual Fund Shareholders*, 2009.

A number of service providers, such as Boston Financial, have worked with funds and CCOs to create tools that support disclosure needs in the transfer agency space. Through regular forums and ongoing exchanges, these providers regularly bring together industry experts to understand new regulations and determine how to adopt best practices.

Building on this transfer agency experience, Boston Financial is developing a suite of products to support the transition and growth of the intermediary marketplace. Leveraging the tools, expertise and knowledge in place today, these products will support a more robust and transparent environment for fund companies and their intermediary partners.

The development of financial intermediary and compliance support technologies will support a more robust and transparent diligence process. As a result, fund companies will be better able to continue to grow while complying with their regulatory responsibilities.



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