

# **ISSA**



## **ISSA Fund Working Group**

Status Report

September 2008

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# 1 Introduction and background

In June 2006, the 13<sup>th</sup> ISSA Symposium endorsed a status report on the work completed by the ISSA Fund Working Group up to then. That report identified ten major barriers and constraints to efficient cross-border funds processing. In a summarized form, the ten barriers were as follows:

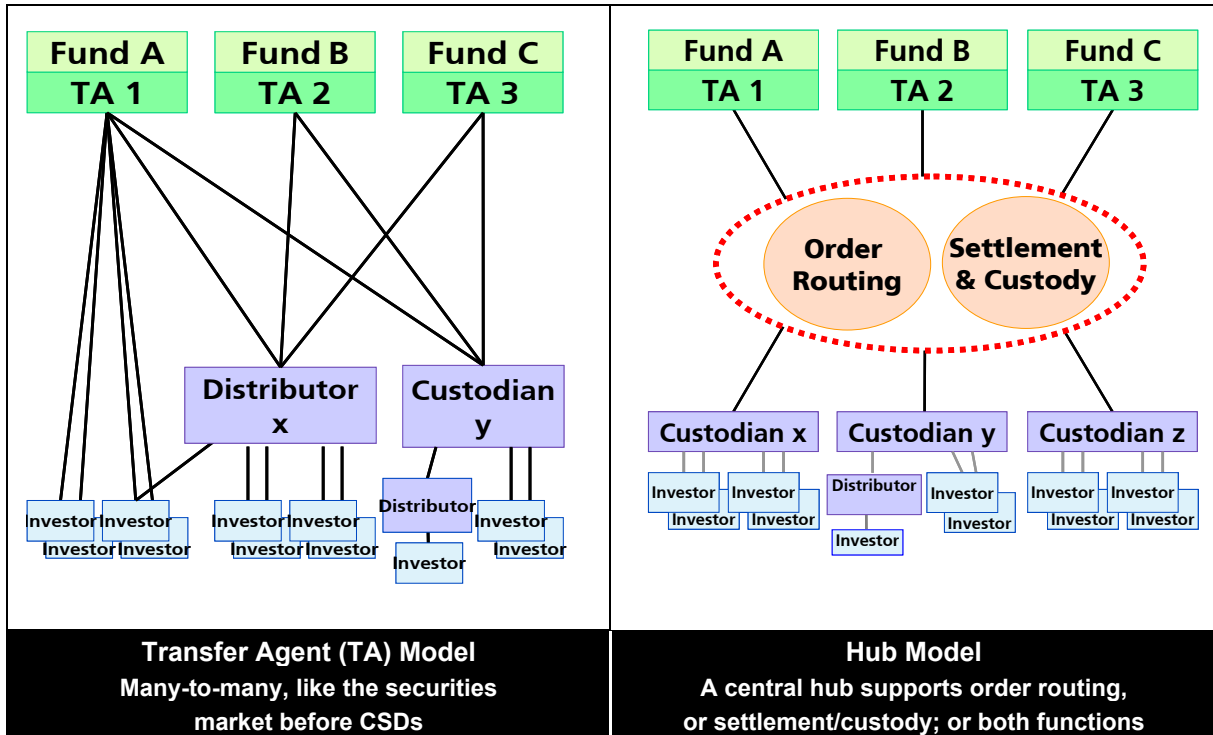
- 1 Lack of harmonized information technology and interfaces
- 2 Lack of common identification and reference data relating to funds and to the counterparties to a transaction
- 3 Lack of agreed-on process life cycle for subscriptions, redemptions and account transfers
- 4 Lack of ability to link the cash and securities leg in one transaction, and lack of clarity on finality of settlement
- 5 Diverse Know Your Customer (KYC) issues, and existence of professional intermediaries which are not regulated entities
- 6 Complex fund features requiring account segregation, disclosure, reporting
- 7 Lack of standardized distribution agreements
- 8 Lack of standardized processes to notify investors on changes to their investment schemes and in the distribution of entitlements
- 9 Lack of harmonized tax systems and tax processing requirements
- 10 Lack of standardized and efficient procedures to calculate and process trailer fees

The work completed in 2006 could be considered as Phase I of an ongoing initiative.

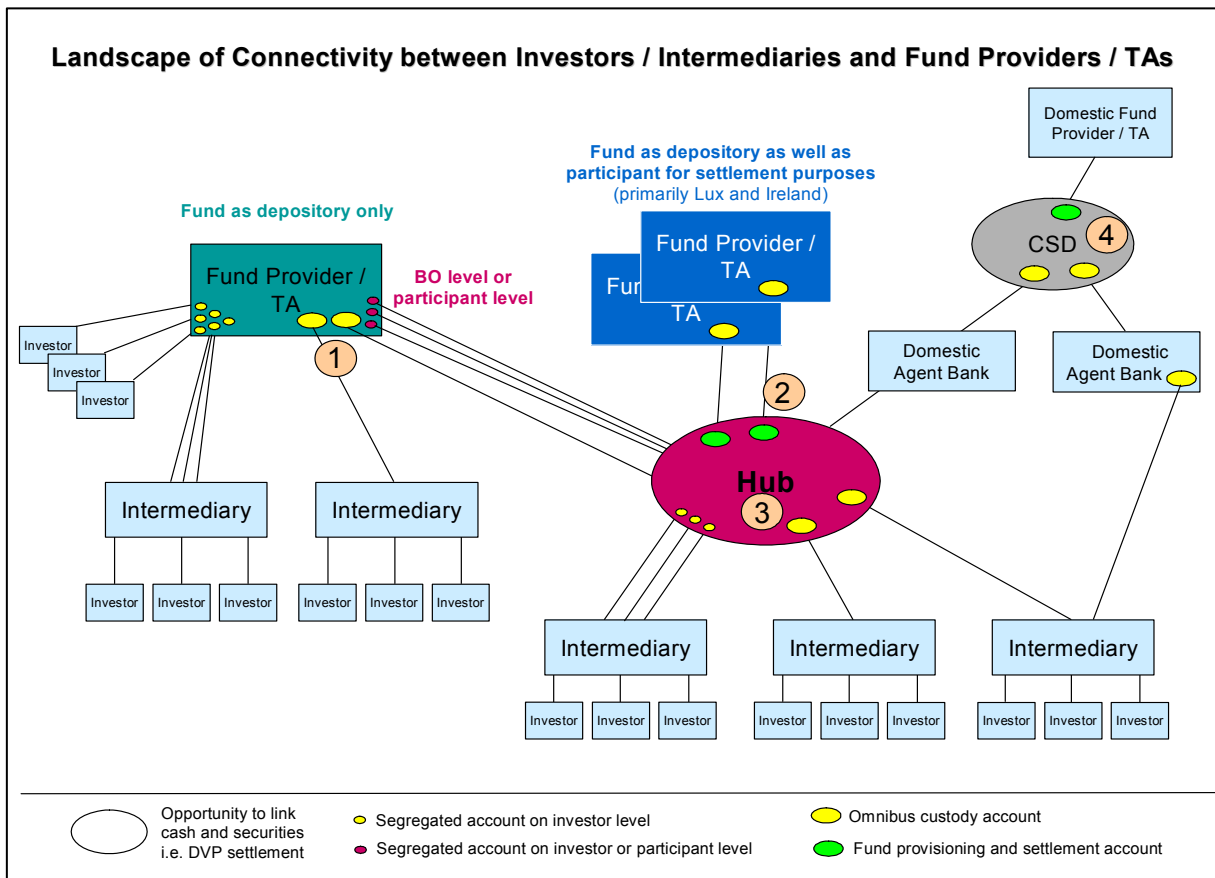
A recurring conclusion throughout the examination of possible operating models for funds in Phase I was that "one size does not fit all". In European cross-border funds processing, two competing business models prevail: the Transfer Agent Model and the Hub Model.

The Transfer Agent Model is based on direct account relationships between fund distributors and funds' transfer agents. This model is specific to the transfer agent-driven fund industry, mainly in Luxembourg and Ireland. It is the older, historically grown model designed for a world of "closed" fund architecture (i.e. in-house or in-group fund distribution) or a "guided" fund architecture if the scope of funds offered by a distributor remains relatively modest.

The younger Hub Model puts a centralized entity in the middle, in the sense of a market place where both sides meet. The hub could be a communications hub only (order routing and related correspondence), or it could be expanded to include settlement and custody. The Hub Model attempts to re-use as much as possible from the established bond and equity processing infrastructure. It is designed for a world of wide open fund architectures and convergence between funds and other asset classes.



An overview of the various possibilities to process funds in Europe is shown in the "Landscape of Connectivity" below:



See next page for explanations

**① Fund acts as depository only**

- Fund shares held in custody with the fund or its transfer agent (TA)
- Separate cash correspondent required to handle the cash leg of a transaction
- No settlement instruction required for subscription and redemption orders

**② Fund acts as depository and CSD (or hub) participant for settlement purposes**

- The fund acts as ultimate custodian but maintains a safekeeping and a cash account with the CSD or hub. Based on accepted trades, the fund creates a fund share and/or cash position in the hub accounts.
- Settlement takes place between the fund's provisioning account and the intermediary's ordinary participant account, both maintained within the CSD or hub.

**③ Hub**

- Enables link between cash and securities (i.e. true DVP) and easy inhouse settlement between participants.
- Can maintain direct accounts with local CSDs for settlement and custody of local funds.

**④ CSD**

- Certain markets already enable DVP settlement and/or registrar functions for domestic funds within their CSD (e.g. Switzerland, Germany, France).

For natural reasons, operations specialists coming from the "sell side" of the market (funds and transfer agents) are more familiar with the Transfer Agent Model, whereas the Hub Model is generally favored by those coming from the "buy side" (integrated distributors such as large custodian banks; and central depositories).

The continued co-existence of two operating models in Europe is a given for the near and mid-term future. However, it seems possible, and indeed necessary, to define principles which facilitate interoperability – if not convergence – towards common best practice.

Since ISSA 13, the funds market environment has evolved significantly: EFAMA published its Funds Processing Passport. ISO 20022 and FIX messages tailored to funds have been developed. National initiatives are pursuing the creation of central funds databases. Market infrastructures launched new order routing tools. Stock exchanges opened up alternative distribution channels through their Exchange Traded Funds (ETFs) segments which enjoy rapid growth. Some stock exchanges offer secondary market trading of funds meant for distribution in a primary market environment. Cross-border investment activity continues to grow in Europe at an accelerating speed.

Facing this proliferation of initiatives in a still fragmented space, the industry to date lacks a truly coordinated approach towards improving and streamlining the operational infrastructure for funds.

ISSA benefits from a balanced representation of fund managers and custodians, and it has a tradition of recommending standards in the general interest of the industry. ISSA therefore is well-positioned to help the industry achieve progress in this area. It is in that context that the board of ISSA launched Phase II of its funds project in 2007.

## 2 Mandate of the ISSA Fund Working Group

The Fund Working Group (WG) constituted in October 2007 guided its activity through the following terms of reference:

The working group's mission is to propose practical ways of gradually reducing barriers to operational efficiency in pan-European cross-border funds processing, aiming to reduce costs and risks to investors, distributors, asset managers, custodians and other providers of securities services.

## 3 Governance, Scope and Methodology

The project was driven by a core team from BNP Paribas Securities Services, Schroders and Citigroup. The formal project sponsor was Jacques-Philippe Marson, President & CEO, BNP Paribas Securities Services. The WG chairman is Edouard-François de Lencquesaing, independent consultant. The WG represented the different stakeholders of the funds industry: asset managers, transfer agents, custodians and market infrastructures. The names of the participating firms and the individual contributors are listed in Appendix II.

The fund product scope was the same as in the previous phase: funds registered for public distribution in Europe, with a focus on UCITS III funds. Likewise, the scope of issues to look into was basically the same as in the previous phase.

Included	Excluded
European registered mutual funds marketed cross border	Domestic funds marketed to domestic investors only, and all exchange traded funds (ETFs)
"Plain Vanilla" funds to include multiple share classes	Complex funds, such as hedge funds with complex features, e.g. holding period requirements
Funds distribution through the involvement of regulated distributors which are eligible for direct participation in CSDs and ICSDs, acting as intermediary between clients and funds	Fund units subscribed and held by the investor directly with the fund company or its transfer agent, without the involvement of an additional intermediary
Needs of all parties involved when a custodial model that employs omnibus accounts is operative	Needs of end investors who hold their assets directly with the fund company/transfer agent
Settlement and asset servicing to include communications and reference data	Legal and regulatory barriers that impede marketing
Unique/country specific challenges of investors in such funds. (It is recognized that such funds are now sold into Eastern Europe and Asia as well as Western Europe and challenges of all investors is within scope)	Processing issues of investors in domestic funds
Legal and regulatory issues that may impede processing to include: - KYC ("Know Your Customer") requirements where intermediaries are involved - Tax reporting/withholding tax issues	Legal and regulatory issues that impact the processing of funds sold only to domestic investors

## 4 From barriers to solutions: a functional approach

At launch of Phase II and throughout the project, the WG was careful not to favor the Transfer Agent Model over the Hub Model, or vice versa. Rather, it looked at the two models' common generic functions and then examined how the barriers identified in Phase I could be overcome or lowered, in the context of those generic functions. The objective of this approach was to facilitate, over time, convergence towards an optimized funds processing environment.

The generic functions were identified as follows:

1. **Distribution.** The number and diversity of distribution channels is proliferating. It is important to identify the major schemes to address regulatory and processing constraints which may hinder straight-through processing (elements of Barriers 5, 7 and 8).
2. **Messaging standards and reference data:** The ISSA barriers (1, 2, 5, 8 and some elements of 3) and the EFAMA recommendations published in 2005 focused on messaging and reference data standards. Domestic market initiatives have started to emerge in this area. ISSA may co-ordinate the transition between the creation of new standards (for example EFAMA's Funds Processing Passport) and their industry-wide implementation. ISSA may also play a role in the creation of a coherent system of databases at the European level, which will improve cost-efficiency for the users. The dimensions to examine are information for funds distribution and information for transaction processing.
3. **Order routing and execution** (mainly barriers 1 and 2).
4. **Settlement** (mainly barriers 3 and 4).
5. **Registration and custody.** This function has two dimensions: information about the investors required by the fund manager; and information about the investment instrument and the fund for the benefit of the investors. This function must deal with account segregation requirements (Barrier 6 and 9), fund information (Barrier 8), fee calculations (Barrier 10) and reconciliation between the investors' and the funds' position ledgers.

The five functions were subsequently prioritized by the group as follows:

1. Messaging standards and reference data
2. Order routing and execution
3. Settlement
4. Registration and custody
5. Distribution

Criteria considered to set the priorities included:

- Potential to achieve quick wins
- Time to market for best practice recommendations vs. the risk of coming late
- Potential for synergies with and acceleration of other initiatives e.g. EFAMA's
- Size of market impact – success in a marginal field is fine but not very effective
- Realistic chance to implement a recommendation

## 5 Functions examined, conclusions and recommendations

### 5.1 Messaging standards and reference data

#### 5.1.1 Discussion

Efficient transaction processing starts with the availability of unique identifiers for the fund, all counterparties and intermediaries involved, and with the essential data required to process a trade.

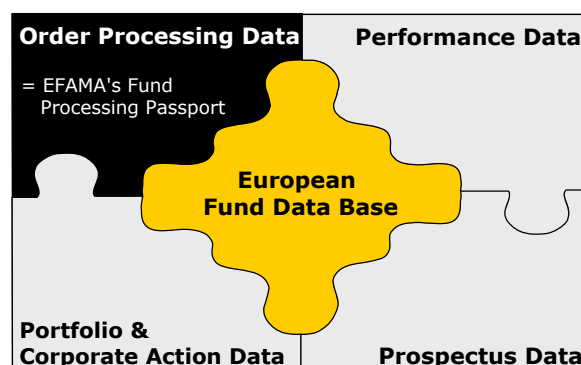
There are already market initiatives to expedite the wide availability of fund reference data, notably driven by EFAMA. EFAMA developed the Fund Processing Passport (FPP) which is a standardized template to collect some 100 data items required by a distributor or a custodian to process a fund order.

The working group discussed the EFAMA Fund Processing Passport (FPP) in the context of the need for an overall pan-European fund reference data base.

Ideally, there should be one central reference data base for all funds registered for distribution in Europe.

"Central" should be understood in the sense of enabling institutional data consumers – market intermediaries in the business of processing fund orders, or distributors – to access the data base through a single window, irrespective of the physical location of an individual data set or the national organization of such aggregated data.

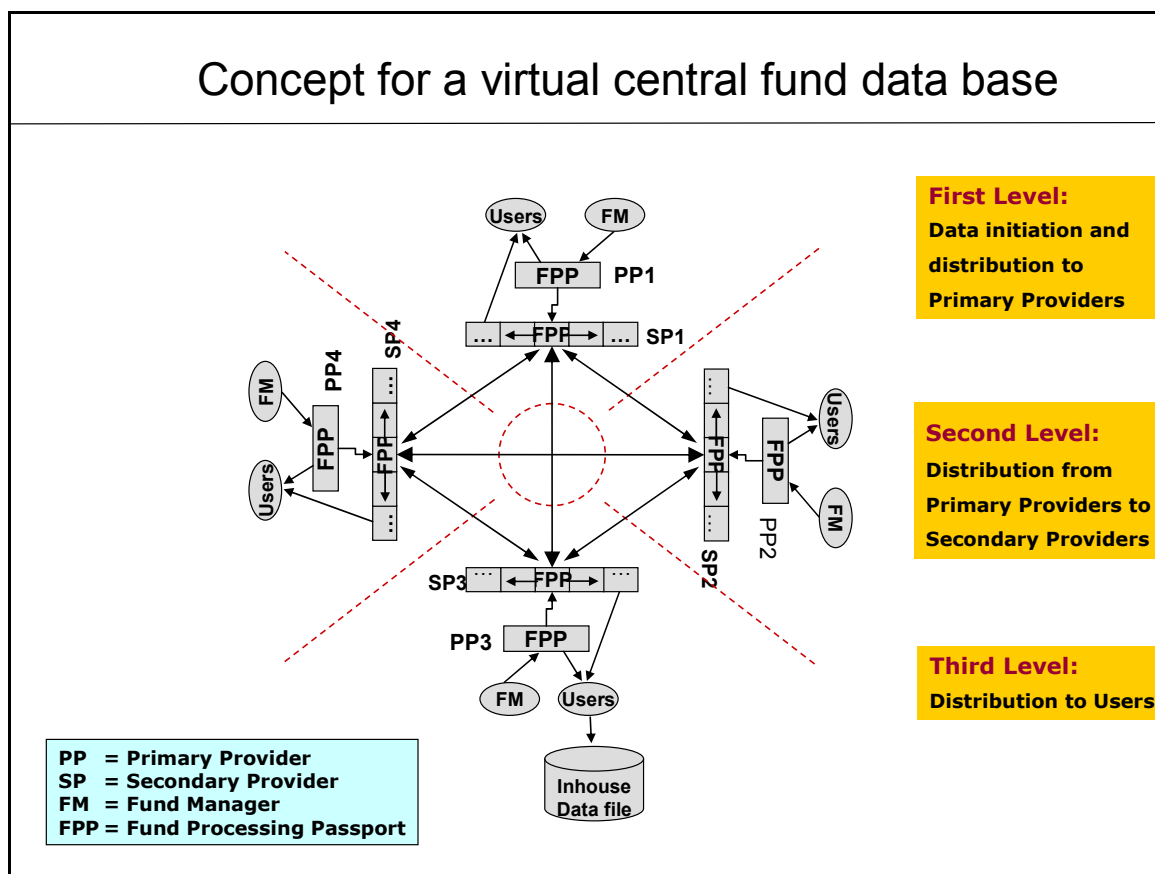
"Central" would also imply an overall architecture that minimizes redundancy, risk and therefore cost involved with maintaining the same data in multiple locations. The EFAMA FPP would be a core building block of such data base. In a later phase, other dimensions could be added to meet additional needs by diverse stakeholders: The fund's Net Asset Value, performance data, fund portfolio data, corporate events data, the full prospectus, etc. Conceptually, this could be illustrated as follows:



The working group convened an industry roundtable in March 2008, bringing most of its own members, EFAMA, and a selection of Europe's key financial instrument data vendors together (see Appendix III for the list of participants).

The objective was to confirm the need for such a database, to explore the chances for success, and to define some high level guidelines to ensure implementation in the best interest of all stakeholders operating in a European cross-border market environment.

A generic model for a "virtual central" database was sketched as the basis of the discussion:



For the purpose of proper analysis and structured discussion, the "fund data universe" was split into two roles or functions, to be tackled separately:

- "Primary data" and their providers: this is the area of the core FPP data;
- "Secondary" data" and their providers and users: this is the area of data for value added services beyond the basic FPP data: Net Asset Value, fund prospectus, corporate actions, fund performance, etc.

Obviously, in real life, many providers of primary data may at the same time also be providers of data in the second category.

The two roles or functions identified above, lead to three process layers that need to be analyzed and defined, in order to arrive at an end-to-end process:

1. *The collection of "primary data"*: The fund managers (or other providers of primary data) have started to get organized on a national basis. An industry-wide, collective common solution needs to be defined more closely, including a clear set of principles on issues such as for instance the allocation of responsibility for data accuracy.
2. *The collection of "secondary data"*: Here, the issue of the optimal overall data base architecture assumes a greater relevance: is the preferred goal one virtual hub, one real central hub, a decentralized model, or something else? The objective is to define conditions and criteria to facilitate the decision for or against specific options.
3. *The distribution of data*: This involves looking at the different types of data users and their specific needs, as well as at the data base maintenance processes.

Below is a summary of the main discussion points and findings that emerged from the roundtable.

## I. Industry Needs

### **The fund order processing industry needs and wants a pan-European fund data base**

From the distributors' and the fund order processors' point of view, the process of funds distribution has two dimensions:

- On one hand, fund managers conclude sales agreements with distributors. A distributor then obviously knows where to obtain fund reference data.
- On the other hand, in an open architecture environment, where there is no ex-ante agreement between distributor and fund, distributors (custodian banks) receive subscription orders from clients for any fund, very often funds domiciled abroad. In this case, the bank first needs to locate the fund and all information required to process the order. Today, too many tasks to obtain those parameters need manual intervention or queries. With the growing popularity of cross-border investing, this scenario is becoming ever more frequent. More efficient ways are needed for accessing such parameters and feeding them into the distributor's internal funds information system, in order to automate the order processing function from end to end, and in order to assure the highest data quality.

### **Internationally active fund managers too, support a centralized data repository**

Fund managers producing funds for distribution in multiple countries welcome ways and means that help their distributors and order processors to distribute their funds in a safe and cost effective manner. An easy delivery mode for the FPP is one important element. A precondition and the first step, however, is to establish an optimized mechanism to collect and compile those data. It would be particularly welcome if fund managers could supply their own fund data to only one, or a few collecting points, for onward dissemination into the market; as opposed to providing them to a separate data vendor in each country.

### **The data providers welcome a standardized format for the collection of fund data**

For the existing data providers, the FPP is an opportunity to facilitate the collection of fund data in a standardized format, to assure coherence between those data and the equivalent data they maintain for other investment instruments. Under this perspective, they may become consolidators of FPPs, integrating the delivery of pan-European fund data into their overall service offering.

## II. Areas of Agreement, common basis for further discussion

### **The EFAMA Fund Processing Passport is recognized as the first major building block**

There is consensus that the EFAMA FPP initiative is of great value to the industry and should be used as a major building block for a larger database. The scope of the FPP does not cover all stakeholder interests. (It was never intended to serve that purpose. The FPP was specifically developed to facilitate one particular step in the fund processing life cycle.) The data providers present stated that the FPP contents represent around 5-10% of the total fund data universe. The

remaining categories are mentioned in the introductory paragraph above. The industry's first priority is the creation and collection of FPPs on a national basis.

### **Each fund manager should designate a "Primary Provider" to create and maintain its FPPs**

The initial production and subsequent maintenance of the FPP are critically important functions to ensure the success of the project. To that effect, each fund manager should designate one party who assumes this responsibility, referred to as the Primary Provider (PP). The Primary Provider is a third party which might specialize in collecting all FPPs in a local market. Obviously, FPPs may also reside on the website of the respective fund manager or its representative (transfer agent or *centralisateur*), for direct access by investors.

The Primary Provider's task is to make the FPP available to individual investors (institutional and retail) on the one hand and to the professional wholesale data vendors for onward distribution into the market on the other hand. In the model scenario sketched on page 10, those data vendors are collectively called Secondary Providers (SP).

To meet the needs of retail investors, publication of the FPP on a public website, perhaps in the format of an Excel table, will in most cases be sufficient. For the Secondary Providers, a more "industrial strength" mode of transportation is required. See the paragraph on ISO 20022 below.

A strong appeal was made to all Primary Providers, to now strictly adhere to the FPP template as the one and binding standard, and to refrain from creating any sub-standards.

### **Connecting existing infrastructures is preferred over building a new database**

The large data vendors in Europe are already used to distributing data (including fund data) to their customers through different channels. Those data are usually collected from various countries. To that effect, the vendors have communication channels between them in place already; reciprocal client/supplier relationships are already well established. Against this background, it may not make sense to build a new central data base from scratch "only" for FPPs. The preferred approach is to improve and expand the existing infrastructures in a way so as to achieve a virtual central database, with multiple access points.

Likewise, the professional clients of the data vendors have no interest in building links to yet another data source. Ideally, they want to be able to obtain all fund data from the same source, and in the same format they already use to access all other financial instrument data.

Therefore, the large data vendors may become Secondary Providers for FPPs. They add value to the market by assuring the best level of consolidation of such data, in response to their customer needs.

### **ISO 20022 is the preferred FPP delivery method to professional data consumers**

Today, the data vendors obtain financial instrument data from their original sources, or exchange them with other intermediaries, in a variety of formats. Although the industry can live with the current situation, a further proliferation of standards is certainly not desirable.

The meeting participants agreed that, over time, the ISO 20022 standard (now in development for funds and the FPP process) is the delivery method of choice. A pragmatic best practice recommendation could read as follows: "The Primary Providers may choose to distribute the FPP data to the Secondary Providers in as many formats they wish, but ISO 20022 must be among them."

In this respect, several tasks were agreed to be tackled by a SWIFT ad-hoc working group:

- Translation of the FPP into ISO 20022 message format; target date for completion was July 2008 [*Note: This was completed and submitted to ISO for approval in September 2008*]
- Implementation of the new messages on the SWIFT network
- Definition of an end-to-end process (and the appropriate messages) to cover all types of "actions" that may occur between the different parties along the processing chain: Creation of an FPP, delivery of an FPP, partial update or modification of an FPP; and including the communication between fund manager and Primary Provider or end user, between Primary and Secondary Provider, and between Secondary Provider and end user. Further aspects to cover included the handling of cut-off times, data circulation on a pull- or push basis, transmission of individual FPPs or data sets versus file transfer of multiple sets; and possibly other issues.

### **Pricing and other commercial issues to be left to the market forces to decide**

The roundtable participants strongly suggested that all commercial and pricing issues should be left to self-regulation by the market forces. They saw no value in a best practice recommendation in this area.

That said, the industry is very interested in seeing pricing models that support the key objectives of the FPP, namely to create value as a sales tool to reach new investors, and for the custodians and other order processors to reduce their overall processing cost.

New and more cost efficient business models should emerge at the level of Primary and Secondary Provider to facilitate the dissemination of FPPs and their integration into existing service offerings.

Some principles for pricing models, based on current practice, were mentioned:

- Free or very low price access for end users requesting individual FPPs through a basic communication protocol (pull system)
- Higher price for access through a more sophisticated protocol
- Charges applied to the fund manager if active distribution is requested to a specified circle of recipients (push system)
- Secondary Providers may receive the data through a push, low cost mode based on a standard protocol. Neither pricing nor technical issues must hinder the FPP dissemination.

### **Liability issues must be clarified through robust Service Level Agreements**

The FPP contains data which, should they be erroneous, entail a potentially high risk in terms of financial consequences. An example is the cut-off time for submitting orders. Service Level Agreements must clearly assign tasks and responsibilities to the parties involved. Agreements will be required on three levels: between fund manager and Primary Provider, between Primary and Secondary Provider, and between Secondary Provider and end user. In principle, on each level the degree of responsibility is in correlation to the difference in quality between data received and data passed on. Those are however classical issues in the financial instrument data industry. They are in no way specific to the funds area.

**Overall summary: creating additional momentum for the EFAMA FPP is a key priority**

Irrespective of any steps taken towards launching a central database project, the immediate priority is to quickly boost the number of FPPs in use. EFAMA is very active in lobbying the fund managers.

ISSA, whose membership is heavy on custodian banks/distributors, should issue a recommendation to exert pressure on those fund managers whose funds they are holding for clients, to complete FPPs as soon as possible.

Using the input gained during the roundtable, the working group followed up on a number of issues and raised additional discussion items.

**Database model**

The discussion clarified several aspects of the model describing a "virtual" central database with Primary Providers (PP) and Secondary Providers (SP):

Even though, for operational reasons, the implementation of this model relies on domestic initiatives, it is necessary to introduce two dimensions about the emergence of PPs, relating to their role as data collectors. Market forces will drive the structures of this new service,

- firstly **at the domestic level** under initiatives taken by the fund industry. Multiple models can be observed at this level (multiple offers in Luxembourg, cross-border offer in the UK [FundConnect], one PP in France [as a portal]),
- secondly, large **pan-European** fund managers may wish to feed all their fund data to a single Primary Provider, rather than working with one in each country where the fund manager distributes its funds. Conversely, a PP may decide to collect fund data from more than one country.

As a result, in the midterm, the industry will face multiple PP in Europe without a clear correlation between PP and countries, and between fund domiciles and PP. At this stage it is still important to support all bottom-up initiatives to create FPP under the responsibility of the fund promoter and to implement a mechanism to make them accessible to distributors and order processors.

SPs will develop several functions in their role as data consumers: collect and centralize FPP, from the diverse PPs, assure coherence between FPPs and their existing funds related data, and distribute FPPs along their existing distribution model. Obviously, a PP may choose to be a SP at the same time.

In this eco-system the industry should define standardized conditions (standards and practices) to develop the best mechanism for the circulation of fund reference data end to end, from the fund via PP and SP to the final user. Obviously, the market will develop multiple solutions. It will be important that they share the same ISO based standard and that one common mechanism exists based on SWIFT's industry role.

It was highlighted that those data are very risk sensitive. Wrong or outdated data may create market risks. It is then crucial to develop in parallel three functions: the first to assure that a golden copy of the FPP remains the collective reference under the responsibility of the fund promoter; the second that a registry function enables the users to determine easily in which PP location a FPP resides; and third that a mechanism assures that modifications of sensitive FPP data are notified to the market as fast as possible and with a certain lead-time. In this context, the ultimate objective is to support the successful roll-out of the EFAMA FPP.

**End-to-end process, role of SWIFT**

In the context of the need for standardized messages to request and obtain FPPs, the potential role of SWIFT was discussed. Three levels of potential SWIFT involvement in the overall process could be envisaged:

Level I: SWIFT delivers ISO messages which the market participants use to communicate directly with the providers of FPPs.

Level II: SWIFT delivers ISO messages and in addition maintains a central registry of all locations where FPPs are maintained. Similar registry or directory services are offered by SWIFT already today. SWIFT could then route the request for an FPP to the party holding the FPP, and that party would send the FPP to the requesting party.

Level III: SWIFT itself manages a central data base. In the terminology used in the roundtable meeting, SWIFT would thus become a Secondary Provider, distinguished from competitors such as Telekurs, WM Daten etc. by the fact that the data universe covered by SWIFT would be limited to fund data.

Level I is a basic industry utility function. Level II could be described as a "value added" utility function. Level III is a commercial business offering.

The immediate industry need is on Level I, i.e. the need for ISO messages to connect the Primary Providers, Secondary Providers and the data users. SWIFT is the logical party to deliver this, and ideally this should be completed by the end of this year.

The initial scope of SWIFT's message development is limited to two messages: 1) Request for an FPP, and 2) the FPP itself, converted to an ISO standard.

Beyond that, however, the large users of ISO standards-based messaging call for a more comprehensive end-to-end FPP process including messages to cover all types of "actions" that may occur between the different parties along the processing chain. They insist that it is crucial for risk management purposes that the "maintenance" messages should be implemented shortly after the creation of FPPs. The list of "actions" to address includes (not necessarily complete, detailed analysis required):

- Creation of an FPP
- Request for an FPP
- Delivery of an FPP (different modes could include a single FPP or a selection of FPPs)
- Modification of an FPP
- Deletion of an FPP, if a fund is liquidated or merged

Questions related to the FPP modification process: Will a full new FPP be delivered each time one field changes and subscribers need to define an inhouse process to detect the change; or will subscribers receive the changed information only and need to define an inhouse process to locate and update the corresponding FPP in their inhouse database? How are lead times handled if crucial FPP elements change, for instance the cut-off time to submit orders?

**Further aspects and market practices to cover**

- Communication between fund manager and Primary Provider
- Communication between Primary and Secondary Provider
- Communication between Secondary Provider and end user
- Data distribution on a pull- or push basis
- Transmission of individual FPPs or data sets versus file transfer of multiple sets

### 5.1.2 Conclusions and recommendations relating to messaging standards and reference data

- 1) The fund order processing industry needs and wants a pan-European fund data base. Internationally active fund managers, too, support a centralized data repository. The major European data providers welcome a standardized format for the collection of fund data.
- 2) The ISSA Fund Working Group proposes a generic model for a pan-European fund database. Its preferred approach is to link already existing infrastructures to a “virtual” central European database. It is however recognized that an “actual” central database built from scratch remains a valid alternative if the proposed concept of the virtual central database does not materialize within reasonable time. The selection and implementation of a particular business model is influenced by commercial issues and those should be left to self-regulation by the market forces.
- 3) The EFAMA Fund Processing Passport (FPP) is the first major building block of a comprehensive fund data base. The successful roll-out of the FPP can be supported by:
  - EFAMA exerting its influence with the fund managers to complete FPPs
  - ISSA calling on the custodians/distributors to exert pressure on the fund managers whose funds they are holding for clients, to complete FPPs as soon as possible.
  - National Numbering Agencies making the availability of an FPP a precondition for issuing an ISIN to a fund.
- 4) The accountability for the accuracy of the data comprising the FPP must not be divided between several parties. Logically, the “Golden Copy” should be produced and maintained by the fund promoter.
- 5) Each fund manager should have an obligation to provide its FPPs to at least one Primary Provider (term explained in the model description).
- 6) The fund manager should mandate its appointed Primary Provider(s) to actively distribute the FPPs onward, to at least one Secondary Provider (term explained in the model description).
- 7) The Primary Providers may choose to distribute the FPP data (initial data and updates) to Secondary Providers in as many formats as they wish, but ISO 20022 must be among them. ISO 20022 is the preferred FPP delivery method to professional data consumers.
- 8) A market practice group including SWIFT, EFAMA and other key parties should, as soon as possible, define a generic end-to-end FPP process (independent of any particular vendor). SWIFT is suggested to take the lead.

## 5.2 Order routing, execution and settlement

### 5.2.1 Discussion

Investments in third party funds are increasing significantly in Europe, both domestically and cross-border. Assets invested in funds roughly doubled over a five year period (2002 – 2007) and this trend continues. From an operational perspective, the objective is to process all trades – including cross-border investments – at or near domestic transaction costs, and using convergent global practices. Today, the operational and risk cost structures are not optimal. For some custodians, the cost of funds processing can reach 80% of their total financial instrument transaction processing costs.

#### General approach and principles

The single, pan-European capital market is still many years away. In the European market environment, efficiency gains can only be achieved in a step-by-step approach. It was stated several times that, even if a visionary and perfect new processing model was proposed which required radical change, the market in its current stage of development would not be prepared to adopt it. The established infrastructures and major market models are a given. However, there are inefficiencies in each, and those should be identified and eliminated.

All national market infrastructures and operating models should become compatible / convergent, ideally applying the same, or at least similar, principles to optimize their internal processes. This will facilitate convergence and consolidation over time and contribute towards better distribution conditions and lower processing costs.

It is a given that the industry works with two major order processing models, the **Transfer Agent (TA) Model** and the **Hub Model**; the latter exists in different variations. Both models are well established and will coexist for an indefinite time. The search for efficiency gains must therefore focus on internal process efficiency within each of the two models, while at the same time aiming for their convergence over time, to the extent possible, especially from the end user's perspective. This means that, for distributors and order processors, the use of either model should be as neutral as possible as far as market practice or standardized interfaces are concerned.

A possible, realistic target is to promote a dual approach: one fully automated Transfer Agent Model and one Hub Model based on the standard best practice, by using the best elements from existing processes and using to the extent possible ISO standards for communication between professional counterparties. From the market user and the transfer agent perspectives the different functions in each model (account opening, order routing, order execution, settlement) should be processed similarly, through common interfaces.

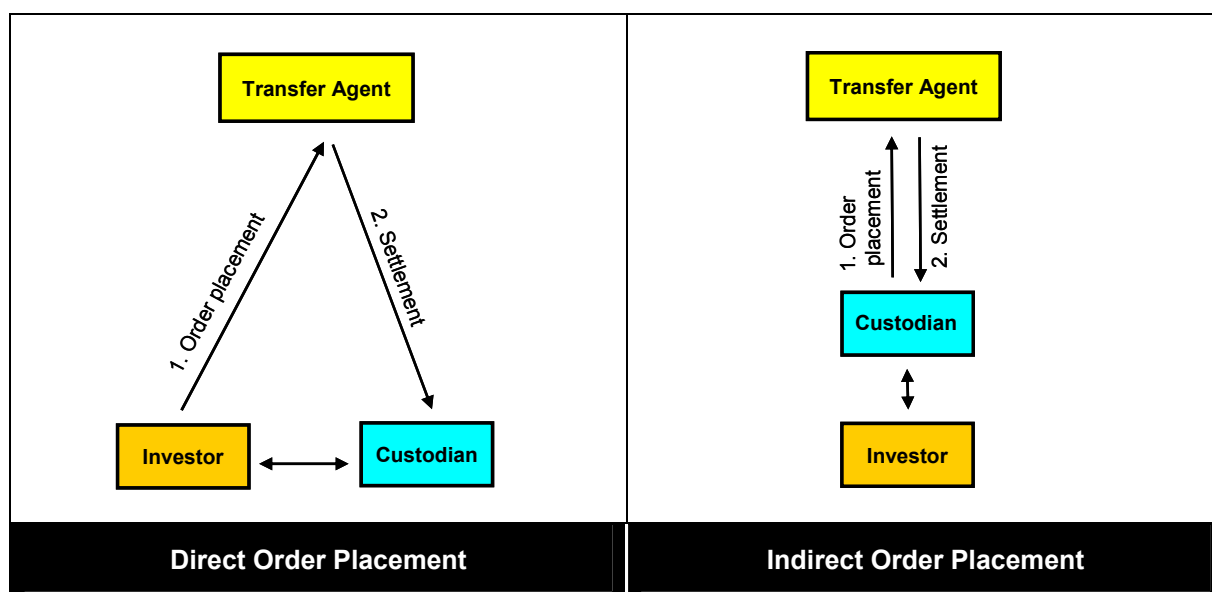
It is estimated that, by promoting automation and best practices between custodians and transfer agents (centralisateurs), the cost of order processing and settlement in those domestic markets dealing with a fully open architecture-type environment could be reduced by 50%. In any case, the cost savings potential is significant. Domestic market experience and know-how could then be leveraged to achieve "bottom-up" convergence in Europe.

The critical building stones for the industry are the individual *functions* comprising the overall process. Therefore, those functions need to be analyzed and optimized, neutral of the operating model. The functions can then be implemented in a variety of scenarios or operating models. Market forces will decide to which operating model the critical mass will flow.

The subject to look at is the order placement, execution and settlement process for an investor (or an intermediary acting on its behalf) who uses a custodian other than the fund or the fund's transfer agent itself. The group assumes that the direct relationship Investor - transfer agent without involvement of a custodian for settlement will remain, but this relationship is outside the scope of this discussion.

Where a custodian is involved, two scenarios exist:

- The investor's custodian may appear at the start of the process, when the investor places an order with his custodian for execution and onward processing. This is referred to as an **indirect order**.
- Alternatively, the custodian may appear at the end of the process when the investor places the order directly with the fund's transfer agent and instructs the transfer agent to settle with the investor's custodian. This is referred to as a **direct order**. This process is usually selected and justified when the investor wants to be recognized by the fund for several reasons, such as to ensure the receipt of trailer fees, or investor communication, from the fund directly.



The order processing environment has a **domestic** and a **cross-border** dimension. For direct orders (investor > transfer agent), cross-border and domestic processes are largely equivalent except for the payment part. In the specific case of Luxembourg, the standard is mainly a cross-border process.

For indirect orders (investor > custodian > transfer agent), the domestic process flow is based on domestic market practices. In the cross-border settlement process, a variety of set-ups are in use today, due to the fragmented national market infrastructures, as illustrated on page 19. The objective is to address this issue.

As a vision, all cross-border scenarios should eventually converge towards a pan-European "domestic" fund market. The same vision applies to the European payments environment and to the conventional securities market, where TARGET2 and TARGET2 Securities are the major convergence initiatives.

The objective should be to reduce the cost of order processing by 50% on a domestic basis, by promoting automation and best practices between custodians and transfer agents (centralisateurs) and by leveraging domestic experience and know-how to achieve "bottom up" convergence in Europe.

**Clarification of terms**

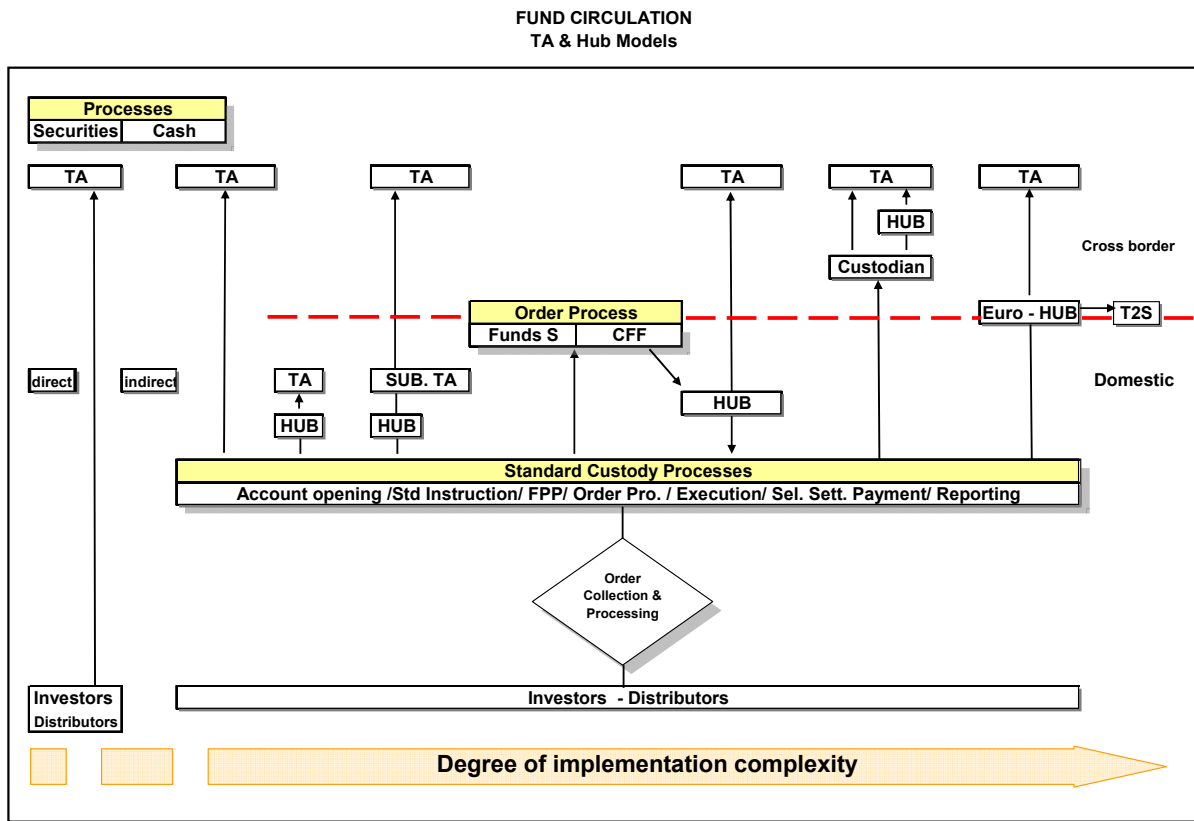
Some terms frequently used in the discussion needed to be clarified as follows, to avoid misunderstandings:

Hub / CSD / ICSD: The term "CSD" is not meant to describe a Central Securities Depository in the narrow sense of the definition, but in a generic or purely functional way, for any kind of a central processing facility in the Hub Model. The same applies for the ICSD (International CSD).

Custodian / Platform: The custodian is the institution that "owns the client" and maintains the client's cash and securities accounts. Facilities such as Vestima and FundSettle are platforms or processing infrastructures. They should not be referred to as custodians.

Investor / Beneficial Owner: In the books of a fund or transfer agent, the investor is the party with whom the fund/transfer agent maintains a contractual relationship. This party may be the end investor, or a distributor. In many cases, the "investor" is not the beneficial owner of the fund shares. Thus, a custodian may appear as an investor in the funds books, but always acting on behalf of an underlying beneficial owner of the assets. Note: a custodian's client is not necessarily the beneficial owner, either. There may be one or more layers of additional intermediaries involved.

**The functions and their performers along the order processing chain**



### Prerequisites for order execution

Before addressing the work flows in the different operational models, some static conditions or tasks deserve a mentioning:

- Execution: includes order execution and issuance of the contract note. In all models, this is the responsibility of the fund, usually delegated to the transfer agent (centralisateur)
- Locating the transfer agent (centralisateur): This task today can be time consuming. Relief will come with the Fund Processing Passport, which will allow automation of this step.
- Standing operational parameters (Cut-off times etc.): Those parameters are also part of the FPP, same as above.

### Account opening

This is a key function as it determines the level of identification of distributors / investors all along the chain. It has an impact on the account structures in the custodian's and the transfer agent's books and by necessity it also impacts the customer reference file information systems and their maintenance practices. The efficiency of the account opening process determines the time when the first order in a particular fund can be executed for a new investor. Increasing the level of automation and the use of standards by all involved parties is then a prerequisite for achieving higher efficiency in this function.

Within the scope of this discussion, "account opening" refers to the process of an intermediary opening an account with the transfer agent to place orders on behalf of an underlying client. The transfer agent should be able to rely on the intermediary having completed, prior to contacting the transfer agent, all "Know Your Customer" requirements with regard to its underlying client.

In this context, it should be understood that the ultimate investor "belongs" to the distributor and his identity is normally not disclosed to the transfer agent. Likewise, it should be understood that the client of a custodian is not necessarily the ultimate investor. The client of a custodian may be a distributor or another intermediary acting on behalf of the ultimate investor. A custodian can in any way not disclose details on parties with whom it has no contractual relationship.

Recommendation: A common business practice should be defined to facilitate and automate the account opening function and guarantee its completion intra-day. There should also be a defined permissible time lag between the account opening and the first order that will follow.

The transfer agent needs to identify all account positions in two ways:

- by distribution agreement for trailer fee allocation purposes; and
- by custodian, for corporate actions, dividend and other entitlement allocation purposes (except in the French market where position keeping is delegated by the transfer agents to Euroclear France and is not tracked by the transfer agents)

The recommendations should include how the account is identified to support those two reconciliation requirements (generic reference such as an ISO code as it has been experimented with successfully in France – or a bilaterally agreed specific identifier, such as an individual account number at the transfer agent level).

For instance, a BIC code could identify the custodian, and an extension to the BIC code could identify the distribution agreement. Alternatively, custodians could maintain a segregated sub-account for each distribution agreement with the transfer agent. The order message would then indicate the appropriate settlement account number.

Custodians, Clearstream and FundSettle today already identify for each client and each fund ISIN the corresponding "TA reference". That reference can be an account number, a distribution agreement number, a name, a short code, or any other type of reference.

Recommendation: The market should work towards a common identifier for the custodian and the applicable distribution agreement. These identifiers should preferably be ISO standards.

### Order routing

In an indirect order placement scenario, typically the custodian opens an account with the transfer agent on behalf of clients. The account set-up should reflect that the custodian acts as an intermediary. If a custodian has underlying clients who maintain individual trailer fee agreements with the fund, then the custodian could maintain segregated accounts for them on transfer agent level.

Each order forwarded by the custodian must then identify the correct transfer agent target account for settlement. There is an ISO standard in place (used in the SWIFT MT 502 message "order to buy or sell") which allows the precise identification of the settlement account as part of the order details. An alternative approach would be for the custodian to supply a unique client ID with the order, so that the transfer agent is able to match the order to a specific agreement concluded between the transfer agent and the custodian's underlying client. It follows that, if a custodian has clients who concluded trailer fee agreements with multiple funds, then the custodian must maintain and manage a corresponding number of segregated accounts with each transfer agent, or a corresponding number of unique client ID codes ("TA references") in its internal reference data files.

Recommendation: Order routing messages should adhere to ISO standards

Recommendation: Irrespective of the order placement model (transfer agent link direct / transfer agent link indirect / via hub), the order message should enable the transfer agent to identify the custodian, and the distribution agreement that governs the transaction.

This recommendation, however, cannot be readily implemented across Europe today, as individual order marking to identify the distribution agreement is not the prevailing practice in all markets. In Germany for instance, there are bilateral agreements between custodians and funds, whereby the custodians periodically give the funds breakdowns of holdings by distribution agreement.

### Settlement instructions

The group had agreed earlier that careful and proper data management within the established processes is more promising than proposing process changes.

Settlement instructions are necessary for the transfer agent to settle the order. Business practice must ensure that complete and accurate settlement instructions are passed on to the transfer agent. There are two ways for the transfer agent to receive settlement instructions (this is mainly relevant to the **direct** order placement scenario):

- Each order contains the full settlement information; or
- Each order contains a reference which can be matched by the transfer agent to a standing settlement instruction which the transfer agent maintains in its own files for each investor, or which the transfer agent could retrieve from a standing instructions database maintained by a third party. This set of data complements the issues mentioned under "Account opening" above.

It was noted that standards and best practice recommendations (e.g. by EFAMA) with regard to the contents and formatting of settlement messages already exist. Compliance is a matter of market discipline which however seems difficult to achieve.

It was also noted that, when defining new message standards for the pan-European market, they must be global at the same time i.e. they must be open enough to accommodate the needs of markets in other parts of the world.

Recommendation: Settlement instructions should adhere to ISO standards.

### Exchanging cash for fund units

Achieving a "true DVP" (Delivery versus Payment) process, as is standard best practice in the equity market, cannot be adopted one for one in the funds market. The funds market is not a secondary market business where securities issued previously are traded and delivered against simultaneous receipt of payment. The funds market is a primary market business, where new shares are issued with each subscription. Moving the newly issued shares to the instructed settle-

ment location, and handling the associated payment, are distinct steps. Normally, prepayment is required before the new shares are issued. Since value is not exchanged for countervalue simultaneously, achieving a process that *guarantees* settlement (i.e. a link between payment and share delivery, but not necessarily a simultaneous link) is of key importance.

Whether settlement finality is achieved by settling the cash leg of the transaction in central bank money or in commercial bank money, is of lesser relevance than it is in the securities market. Market participants have a choice between both options today. The group did not consider a recommendation necessary.

To illustrate, the working group representatives of the established hub solutions explained the relevant features in their models which find broad and unquestioned market acceptance, without a true DVP process:

- FundSettle applies a DtP (Delivery then Payment) process, where the cash and securities leg are linked, albeit not simultaneously. The share settlement is a reflection of the share settlement done in the Transfer Agents' Books; the cash settlement ensures the payment flow between the custodians' account with Euroclear and the external cash account of the funds.
- Clearstream's Central Facility for Funds (CFF) does not actually hold the transfer agent's fund shares. CFF *reflects* share positions which the transfer agent posts to its own issuance account. Cash and shares are therefore not "physically" exchanged on the same platform.
- A third model is in the process of implementation in the French domestic market through Euroclear France, referred to as a "delegated hub DVP process". This involves a mirrored issuer account, held by the centralisateur in the books of the CSD.

This important issue should be examined in more detail. Step by step, technical or legal innovation may lead to convergence over time, probably starting at single country level.

The issue of **counterparty credit risk** seems to rise in importance in the funds settlement environment: Large investors placing simultaneously large orders for multiple funds with several transfer agents create a potential systemic risk if payment is not made on time. The transfer agents cannot be expected to absorb that risk. This is an issue to be addressed in the agreement between fund manager and distributor. A prepayment requirement is a way to manage that risk.

### **Aligning the settlement cycles of funds with those of their underlying instruments**

The working group suggested a recommendation to align the settlement cycles of the funds with those of their underlying instruments.

It was noted that EFAMA was working on a similar recommendation, worded as "*Settlement should occur on T+3 (where "T" is the date on which the order is priced) or earlier, according to the settlement cycles of a fund's underlying assets. In exceptional cases, the nature of a fund's assets and the associated settlement timeframes may require a longer period.*" This concept was supported. There are however funds with underlying portfolios composed of asset classes with varying settlement cycles. Those might have to be dealt with in a separate recommendation. More analysis was suggested.

### **Multiple settlement cycles for the same fund due to secondary market trading**

Working group members had different perceptions of how significant secondary market trading in practice actually is. Fact is that there is investor demand for it, it is done, and several market places are actively promoting it. The group saw value in defining best practice recommendations to facilitate smooth workflows involving secondary market trading, both for local and foreign funds traded at a particular exchange. An immediate suggestion was not to allow a fund's settlement cycle to vary depending on the trading place. The entire issue of secondary market trading however was earmarked for more analysis.

### **Moving towards a coherent settlement framework; leveraging the hub approach**

The group agreed that discussing the feasibility of a single European settlement and custody hub for funds was premature. Even in the conventional securities markets with much larger volumes, a single European CSD (or other form of central settlement hub) is not a reality and the linking of domestic hubs is still difficult. However, the cross-border dimension is a reality. To work properly in a hub context:

- The non-resident fund should be accepted for distribution and processing in the country of the hub.
- The non-resident fund will then benefit of the local process in the same way as a domestic fund.
- Some funds use sub-transfer agents in different distribution countries. Those sub-TAs process funds according to local rules and practice and then liaise with the main transfer agent in the fund's domicile. This may be a further area where potential for efficiency gains and convergence may be identified.

The pan-European hub in its order processing function exists already: FundSettle (Euroclear) and Vestima (Clearstream). Those competitive platforms concentrate orders on a pan-European basis and route them into various settlement processes chosen by their users.

In some local markets (mainly Luxembourg) the funds business is predominantly a cross-border business. In others, it has remained more local to date. As volumes increase in those markets, too, the goal should be to leverage existing initiatives in all markets and converge progressively, using a bottom-up approach, towards a pan-European scheme.

## 5.2.2 Conclusions and recommendations relating to order routing, execution and settlement

- 1) A common business practice should be defined to facilitate and automate the account opening function and guarantee its completion intra-day. There should also be a defined permissible time lag between the account opening and the first order that will follow.
- 2) The market should work towards a common identifier for the custodian and the applicable distribution agreement. These identifiers should preferably be ISO standards.
- 3) Order routing messages should adhere to ISO standards
- 4) Irrespective of the order placement model (transfer agent link direct / transfer agent link indirect / via hub), the order message should enable the transfer agent to identify the custodian, and the distribution agreement that governs the transaction.
- 5) Settlement instructions should adhere to ISO standards.
- 6) Domestic initiatives, if the critical mass exists, should be able to leverage existing hubs (either for order processing or for settlement, or even for both) and automate the domestic circulation of funds. Cross-border experience should be matched to facilitate convergence.
- 7) On a cross border basis existing market initiatives should be promoted as it is the case with FundSettle and Vestima.

## 5.3 Registration and custody

### 5.3.1 Discussion

This function has two major dimensions: information about the investors required by the fund manager; and information about the investment instrument and the fund for the benefit of the investors.

More specifically, this function must deal with account segregation requirements on transfer agent level, trailer fee and similar commission calculations, and reconciliation between the investors' and the funds' position ledgers.

During Phase I of the initiative, the previous ISSA working group had summarized the main challenges and their underlying causes as follows:

For a variety of reasons, transfer agents may require a "look-through" at least to the level of the distributor, if not to the end-investor. The listing below may not be exhaustive:

- Legal/regulatory needs to obtain as many details as possible on the beneficiary (e.g. late trading/market timing; refer to SEC Rule 22c-2 in the United States)
- Tax/regulatory restrictions on transferability (e.g. stamp duty on UK funds)
- Transfer agent requirement to know the distributor for trailer fee and marketing reasons

- Prohibition by some funds/transfer agents to perform inhouse settlements between omnibus accounts within a ICSD/CSD. Underlying reason is again trailer fee tracking.
- Special commission structures, such as Contingent Deferred Sales Charges (fee charged only when a special circumstance occurs, for example if a holding period applies and the investor decides to sell the fund prematurely)
- Products for which the tracking of holding periods or other account history is necessary (e.g. aged trailers, number of transfers allowed in a given time period, restriction on switches, etc.)
- Tracking and reporting of individual ownership limits in the fund
- Tracking and reporting of individual or aggregate ownership on clients' holdings in foreign funds

The above requirements notably prevent the fungibility of funds and order aggregation opportunities.

Further, the need for transfer agents to track data required to correctly determine the eligibility of a position to trailer fee entitlements, is the largest barrier preventing the alignment of funds and equity processing. The complexity is multiplied by the large number of methods in place to calculate such entitlements. Fund companies are not focused on standardization, but rather on maximized distribution at minimal administrative burden to themselves. Requirements and obstacles as seen *from the viewpoint of the fund/transfer agent* include the following:

- Difficulty to identify client assets when they are dealing via a platform or CSD
  - If assets are not clearly identified by investor, tailored reporting per client cannot be created. Trailer fee calculations can be made on incorrect holdings or average holdings. Additionally, deals tend to be bulked together. In that case, special pricing conditions applicable per client / Independent Financial Adviser (IFA) cannot be applied as specific instructions are not visible. For that reason CSD account transfers without transfer agent involvement work only if the fund has a uniform fee agreement with all CSD participants. It does not work if CSD participant X has a different trailer fee agreement with the fund than participant Y. In such case, a CSD must report movements by participant (= distributor). This adds another element of complexity: A CSD must be able to recognize a participant as a funds distributor. The transfer agent or fund manager then maintains a shadow accounting system for each distributor.
  - The process of identification is manual and often requires statements to be provided by the parties involved, reconciliation with the shareholder register and manual calculation.
  - This is a timely process, risky and requires headcount allocation.
  - Business Finance cannot track assets and dealing patterns for internal reporting. Assets cannot be properly allocated at country or business channel level.
  - Sales commissions cannot be correctly allocated.
  - The link between fund/transfer agent and client is lost, no investment pattern can be seen or tracked, mailings are made to a central platform (for onward circulation), client specific questions cannot necessarily be answered as holdings are not visible.
- Non- standardized communication of holdings
  - No industry standard of communication like the ISO message type MT535 (statement of holdings). Data flows are often done through unstructured spreadsheets, faxes, account statements issued by custodians etc.
  - High level of manual input, leading to higher operational risk.
  - No agreement on timing of data submission; clients can submit records for historic periods.

- Fund companies do not limit themselves to a time frame within which rebates can be claimed for commercial reasons.
- Unclear ownership of holdings
  - Cascading custodians lead to double counting risk.
  - To prevent double counting, fund companies tend to insert clauses into their distribution contracts requesting the disclosure of the ultimate investors.
- Indefinite number of calculation schedules and –methods
  - The number of different calculation methods is huge (e.g. working days, calendar days, including / excluding certain share classes, traded/settled positions, etc.)
  - Calculation formulae may be combined with different timings, daily, daily average, weekly, end of period, average over period etc, leading to a non standard solution for each client.
  - Changes in the currency of a fund are generating additional problems in case average values should be used.

In the four regular working group meetings held to date, the registration and custody function was not yet addressed in a structured way. However, all meetings raised and discussed issues that fall under custody services. Those are consolidated below.

#### **Dematerialization of fund certificates**

The group calls for the full dematerialization – or at least immobilization – of all funds registered for distribution in Europe. In fact, paper should be removed from the entire funds processing cycle,

to the extent possible, and follow the same automated mechanisms that are in place for conventional securities.

Recommendation: Unless prevented by law, all funds registered for distribution in Europe should be fully dematerialized. As a minimum, circulation of physical fund certificates should be immobilized to the greatest extent possible.

#### **Trade date vs settlement date accounting**

Transfer agents' accounting systems use a trade date based view, whereas custodians' accounting systems are generally settlement date based. The reconciliation process between the two always requires adjustments. A suggestion was made for a best practice recommendation to bridge the two views.

Recommendation: Transfer agents' and custodians' position tracking systems should support both a trade date based and a settlement date based view.

### **Position transfers**

End investors may choose to change their custodian relationship at any time and for any reason. If a fund position which is linked to a particular trailer fee agreement is moved from custodian A to custodian B, it is essential that the transfer agent is informed of the change without delay, as it needs to re-direct the trailer fee payment stream.

Recommendation: If a fund position which is linked to a particular trailer fee agreement is moved from custodian A to custodian B, it is essential that the transfer agent is informed of the change without delay. It is recommended that such position moves are instructed by electronic file transfer, with a copy sent to the transfer agent for immediate information.

### **Client information reporting**

The mode of reporting underlying client information by intermediaries to transfer agents was identified as an area with room for improvement. Almost every transfer agent has its own specifications concerning information contents and reporting format. A best practice recommendation could help to streamline this process. This issue was earmarked as a possible future work item.

### **Trailer fee reporting and reconciliation**

Trailer fee allocation, reporting and reconciliation is an element in the funds processing cycle with potential for harmonization, standardization or other forms of improvement. The group is aware that EFAMA has undertaken great efforts to analyze this topic in detail for quite some time. Its work is now in an advanced stage. The group agreed not to duplicate that effort. An ISSA recommendation in this field is not an urgent need.

### **Common best practices for transfer agents / centralisateurs**

With regard to the relationships between the transfer agents and investors, custodians or hubs, a general recommendation is to accelerate the convergence of business practice between them, and the drive towards a paperless operating environment, to increase efficiency and reduce costs and risks.

### **Custodians' due diligence process with regard to transfer agents**

On several occasions, the group pointed out the need to strengthen risk management in general. The custodian due diligence process with regard to transfer agents was pointed out specifically.

In the securities market environment, global custodians are selecting their sub-custodians and other agents with great care. Usually they have a choice amongst several competitors. In many markets, global custodians engaging local agents have legal or regulatory due diligence requirements they must comply with.

In the funds market, global custodians have no choice between alternative transfer agents for a given fund. There is only one transfer agent, appointed by the fund manager. In theory, the investor is assumed to have read and accepted all parts of the prospectus prior to placing an order. He knows who the transfer agent of his fund shares is, and presumably has agreed to have his fund shares ultimately deposited with that agent. The global custodian should therefore not be held accountable in the event of a transfer agent default. Moreover, even in case of transfer agent bankruptcy, the investor still keeps his entitlement to the fund shares which were issued by the transfer agent obviously in its capacity as an agent only, on behalf of the fund company. In reality however, it is not a universally accepted principle that a global custodian is not responsible for the standing of a transfer agent. Regulators and supervisory bodies tend not to acknowledge the lack of choice for the global custodian. Creating the necessary awareness may be a future work item for the group, for individual group members, or for ISSA.

Apart from a default scenario, due diligence has operational aspects as well. A custodian must be comfortable when dealing with a transfer agent. It would be useful to facilitate the operational due diligence process for transfer agents. Common best practices for operational risk management are desirable, for instance with regard to settlement, position holding and reconciliation.

One suggestion was to consider the drafting of a "Code of Conduct" to facilitate an industry-wide due diligence process, and to define common principles on the usage of standards and business practices.

The due diligence process tends to be time consuming and expensive. Where hub approaches are used, it is conceivable that an operational due diligence review could be done by the hub on behalf of its users; several hubs could even adopt a common policy. The process may involve the creation of a "quality label", awarded to transfer agents that meet the due diligence criteria specified by the hub operators. This was not discussed in detail but put aside as a potential future work item. [Note: FundSettle has already defined certain quality standards for transfer agents]

### **5.3.2 Conclusions and recommendations relating to registration and custody**

- 1) Unless prevented by law, all funds registered for distribution in Europe should be fully dematerialized. As a minimum, circulation of physical fund certificates should be immobilized to the greatest extent possible.
- 2) Transfer agents' and custodians' position tracking systems should support both a trade date based and a settlement date based view.
- 3) If a fund position which is linked to a particular trailer fee agreement is moved from custodian A to custodian B, it is essential that the transfer agent is informed of the change without delay. It is recommended that such position moves are instructed by electronic file transfer, with a copy sent to the transfer agent for immediate information.
- 4) Trailer fee allocation, reporting and reconciliation is an element in the funds processing cycle with potential for harmonization, standardization or other forms of improvement. The group is aware that EFAMA has been analyzing this topic in detail for quite some time. ISSA should not duplicate that effort. ISSA is supportive of EFAMA's work and is prepared to assist but will not take a lead in this field.
- 5) An industry-wide common "Code of Conduct" to support custodians in their due diligence process as it relates to transfer agents, should be considered.

## 5.4 Distribution

This function was set aside for a next project phase, given the group's focus on order processing, custody and asset servicing issues. Under the heading "Removing paper from the process flow", the group identified a context to an initiative lead by Schrodgers to dematerialize fund sales agreements. This project aims at replacing individual, paper-based fund sales agreements with more standardized agreements that are suitable for electronic transmission. A standard agreement could consist of a core element of universally applicable terms, and an add-on containing terms specifically needed in the target distribution market.

The EFAMA FPP follows the same concept: a core section of universally applicable data, and country add-ons for target distribution market specific data.

If eventually, the two initiatives could be aligned and the document containing a funds key operational data (= the FPP) could be linked to the document containing the funds legal terms for distribution, both in a standardized and electronic format, a significant step towards removing paper from the funds processing flow could be realized.

The group suggested to explore the potential for alignment of these initiatives. More analysis is necessary.

## 6 Next Steps

The essence of this report was presented to the 14<sup>th</sup> ISSA Symposium, held in June 2008. The ISSA members present described the major items raised as "mission critical", particularly in the reference data and Fund Processing Passport area, and encouraged the group to continue its work. It was recommended to deepen the analysis in the operational area and to refine the recommendations made to date.

The ISSA board gave green light to draft a new work plan for the remainder of 2008 and 2009. It was noted that the ISSA agenda must be compatible with, and complementary to, the parallel EFAMA initiative. Going forward, the ISSA working group intends to focus more on operational issues driven by distributors, order processors and constraints from the viewpoint of a custodian.

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A considerable amount of progress has been achieved in a short period of time. The ISSA board wishes to thank all working group members and their firms for their commitment and active contribution to date.

## **Appendix**

- I. Consolidated list of conclusions and recommendations to date**
- II. List of ISSA Fund Working Group members**
- III. List of industry roundtable participants**

## Appendix I: Consolidated list of all conclusions and recommendations to date

### Messaging standards and reference data

- 1) The fund order processing industry needs and wants a pan-European fund data base. Internationally active fund managers, too, support a centralized data repository. The major European data providers welcome a standardized format for the collection of fund data.
- 2) The ISSA Fund Working Group proposes a generic model for a pan-European fund database. Its preferred approach is to link already existing infrastructures to a "virtual" central European database. It is however recognized that an "actual" central database built from scratch remains a valid alternative if the proposed concept of the virtual central database does not materialize within reasonable time. The selection and implementation of a particular business model is influenced by commercial issues and those should be left to self-regulation by the market forces.
- 3) The EFAMA Fund Processing Passport (FPP) is the first major building block of a comprehensive fund data base. The successful roll-out of the FPP can be supported by:
  - EFAMA exerting its influence with the fund managers to complete FPPs
  - ISSA calling on the custodians/distributors to exert pressure on the fund managers whose funds they are holding for clients, to complete FPPs as soon as possible.
  - National Numbering Agencies making the availability of an FPP a precondition for issuing an ISIN to a fund.
- 4) The accountability for the accuracy of the data comprising the FPP must not be divided between several parties. Logically, the "Golden Copy" should be produced and maintained by the fund promoter.
- 5) Each fund manager should have an obligation to provide its FPPs to at least one Primary Provider (term explained in the model description).
- 6) The fund manager should mandate its appointed Primary Provider(s) to actively distribute the FPPs onward, to at least one Secondary Provider (term explained in the model description).
- 7) The Primary Providers may choose to distribute the FPP data (initial data and updates) to Secondary Providers in as many formats as the wish, but ISO 20022 must be among them. ISO 20022 is the preferred FPP delivery method to professional data consumers.
- 8) A market practice group including SWIFT, EFAMA and other key parties should, as soon as possible, define a generic end-to-end FPP process (independent of any particular vendor). SWIFT is suggested to take the lead.

### Order routing, execution and settlement

- 1) A common business practice should be defined to facilitate and automate the account opening function and guarantee its completion intra-day. There should also be a defined permissible time lag between the account opening and the first order that will follow.
- 2) The market should work towards a common identifier for the custodian and the applicable distribution agreement. These identifiers should preferably be ISO standards.

- 3) Order routing messages should adhere to ISO standards.
- 4) Irrespective of the order placement model (transfer agent link direct / transfer agent link indirect / via hub), the order message should enable the transfer agent to identify the custodian, and the distribution agreement that governs the transaction.
- 5) Settlement instructions should adhere to ISO standards.
- 6) Domestic initiatives, if the critical mass exists, should be able to leverage existing hubs (either for order processing or for settlement, or even for both) and automate the domestic circulation of funds. Cross-border experience should be matched to facilitate convergence.
- 7) On a cross border basis existing market initiatives should be promoted as it is the case with FundSettle and Vestima.

### **Registration and custody**

- 1) Unless prevented by law, all funds registered for distribution in Europe should be fully dematerialized. As a minimum, circulation of physical fund certificates should be immobilized to the greatest extent possible.
- 2) Transfer agents' and custodians' position tracking systems should support both a trade date based and a settlement date based view.
- 3) If a fund position which is linked to a particular trailer fee agreement is moved from custodian A to custodian B, it is essential that the transfer agent is informed of the change without delay. It is recommended that such position moves are instructed by electronic file transfer, with a copy sent to the transfer agent for immediate information.
- 4) Trailer fee allocation, reporting and reconciliation is an element in the funds processing cycle with potential for harmonization, standardization or other forms of improvement. The group is aware that EFAMA has been analyzing this topic in detail for quite some time. ISSA should not duplicate that effort. ISSA is supportive of EFAMA's work and is prepared to assist but will not take a lead in this field.
- 5) An industry-wide common "Code of Conduct" to support custodians in their due diligence process as it relates to transfer agents, should be considered.

### **Distribution**

To be addressed in the next project phase.

**Appendix II: List of ISSA Fund Working Group members**

<b>Institution</b>	<b>Name</b>	<b>Function</b>
	Edouard-François de Lencquesaing	Consultant, WG Chair
AXA Asset Managers Deutschland GmbH	Vanessa Grünekle	Head of Cross-Border Client Management
BBH Limited	Simon Cleary	Senior Vice President, Investor Services, Funds Solutions
BBH Limited	Sebastien Chaker	Vice President, Investor Services, Funds Solutions
BNP Paribas Securities Services	Fred Perard	Head of Product Development, Funds Services
BNP Paribas Securities Services	Christine Bodolec	Funds Services
Citigroup International Plc (Luxembourg Branch)	Stefano Pierantozzi	Director, Head of EMEA Fiduciary Oversight & Research
Clearstream Banking	Christian Westerholt	Head of Product Management, Investment Funds Services
Clearstream Banking	Philippe Van Hecke	Senior Vice President, Market Management, Investment Fund Services
DTCC	James Kiernan	Director, Wealth Management Services
Euroclear	Lieven Libbrecht	Director, Product Management Funds
Franklin Templeton Investments	Sarah Nicklin	International Transfer Agency
HSBC Trinkaus & Burkhardt AG	Götz Röhr	Director, Head of Customer Relations and Product Development, Securities Services
HSBC Trinkaus & Burkhardt AG	Gregor Busshoff	Customer Relations and Product Development, Securities Services
Schroders Fund Services	Gary Janaway	Head of Operations
SWIFT	Jean Sonnevile	Managing Director, Head of Investment Management Services
SWIFT	Sven Bossu	Market Manager Funds
UBS AG	Erhard Heumann	Market Infrastructure and Market Initiatives
UBS AG	Peter Gnepf	ISSA Secretariat

### **Appendix III: List of industry roundtable participants**

The industry roundtable discussion with senior representatives from leading financial instrument data providers was hosted by SWIFT at La Hulpe, on March 7, 2008

#### **ISSA Fund Working Group members**

- Edouard de Lencquesaing (Chair)
- Sebastien Chaker, BBH
- Anne-Sophie Remacle, Citigroup
- Philippe van Hecke, Clearstream
- James Kiernan, DTCC
- Lieven Libbrecht, Euroclear
- Jean Sonnevillie, SWIFT
- Sven Bossu, SWIFT
- Erhard Heumann, UBS
- Peter Gnepf, UBS / ISSA Secretariat

#### **Guest participants**

- Dominic Leblanc, Fininfo
- Carsten Mahler, FundConnect
- Mario Mantrisi, KNEIP Communication
- Nourredine Yous, Telekurs Financial Information
- Rudolf Siebel, EFAMA and German Investment and Asset Management Association BVI
- David Broadway, EFAMA and UK Investment Management Association IMA

#### **Invitations extended / discussions held separately**

- Dominique Valschaerts, CCLux
- Marie Helène Créto, NYSE Euronext
- Max Baumann, Swiss Fund Data AG
- Steven Kundermann, WM Datenservice