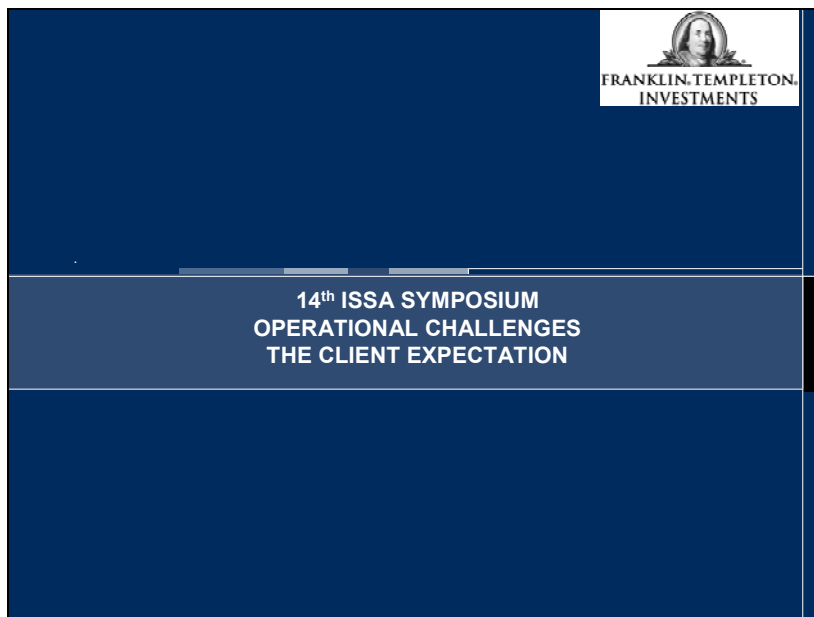


Jimmy Gambill



We heard this morning that our industry is in the midst of change. Are we at an inflection point, as Amin Rajan said? It could well be. It seems to be an evolutionary inflection point as – to some extent – I have seen the same evolution over the last twenty years. The operational units always attempt to keep up with the speed of innovation in the front office. It is very difficult for the backoffice to keep up with that change in a cost-effective way. The demand on operations is to do everything faster and cheaper at the same time. In the end, we all try to meet the needs of our ultimate customers.

So what are the operational challenges that we are facing in this changing world? On a high level, the drivers are listed in the next slide:



We constructed a grid to categorize our investment clients, focusing on the international institutional market segment:

Changing Profile of the Investment Client		FRANKLIN TEMPLETON INVESTMENTS					
The opportunities are anything but “standard”							
Client strategy:	Local Advisors	Fund of Funds	Global Advisor	3 rd Party Mgr			
Role of consultants:	Minimal	Local is Key	Global is Key	Both are Key			
Investment vehicle:	Separate Account	Mutual fund	Advice-Only	White Label			
Currency used:	€	¥	£	USD	RMB		
Primary language:	English	Mandarin	Spanish	Italian	Cantonese	French	German
Role of custodians:	None	Low	Moderate	Sophisticated/High (as in U.S.)			
Mandate:	Class (Equity/FI / Alternative)	Geography (Global/Regional /Local)	Market Cap	Risk	Value/ Growth		
Reporting standards:	None (Custom)	Low	Moderate	Well-developed (Standard)			

This slide shows that the number of permutations of product, client, registration, degree of integration with the custodian, reporting language, the currency that the product is either denominated or hedged in, the type of mandate, and the reporting standards create an almost infinite number of product features that we have to support. One of our major challenges is: How can we do this with scale? One answer is standardization. I will come back on that later.

- | Speed of Change in Product Development | | FRANKLIN TEMPLETON INVESTMENTS | | | |
|--|--|--------------------------------|--|--|--|
| <ul style="list-style-type: none"> ➤ Evolving Client Demands creates Reactive Product Development ➤ First Mover Advantage ➤ New regulatory or tax changes create “instant” opportunity or challenge ➤ Increasing Requirements from Regulators to Register Products or Client Accounts ➤ Lead Time to Establish Trading Accounts - ISDA | | | | | |


The speed of change in product development clearly accelerated in the past few years. When I started with Franklin Templeton twenty years ago, we typically had one or even two years to identify the client's need, develop the foundation of the product, get it approved by the regulator, get it through the marketing department.. And hopefully by that time, we had developed the operational infrastructure to support and manage it. Today, the customers have no patience anymore for that. They need something, and they need it *now*. So how do we typically accommodate that internally within operations? We start out with a very manually intensive support infrastructure, with many additional people and lots of spreadsheets. Then hopefully over time, we can automate and integrate that process.

The driving event behind this need to do everything very fast is the first mover advantage. We have seen this primarily in the newer markets: The first one to launch a new product attracts the bulk of the assets. The Korean market is a typical example for that. From a business perspective, the first mover advantage is absolutely key. The ability to be responsive to change is a big driver towards the success of a

company.

In addition to that, the regulatory and tax changes occurring in any one country can create an instant opportunity – or an amazing challenge. Again, you have to be responsive to that as soon as a new law is passed, or as soon as the opportunity becomes available, because your competitors are not sleeping.

There are increasing requirements from regulators when it comes to registering new products. We are seeing that, in order to just get our client accounts registered in various countries, the demand for information has gone up dramatically. There may be several factors around that. One is that countries are much more careful about who is investing in their economies. There is nothing wrong with that, but it extends the time line in terms of our ability to get our clients up and running in a particular market. The ISDA Agreement for establishing derivatives trading is a case in point. We have seen time lines as long as nine months to get an ISDA Agreement implemented with some of our counterparties. If you are funded to invest a particular mandate and that mandate includes the use of derivatives and you are nine months behind in your ability to execute, that can dramatically impact your investment performance.

COMPLEXITY OF PRODUCTS vs OPERATIONAL CAPABILITIES	
<ul style="list-style-type: none">➤ Lack of Flexibility in Legacy Accounting Systems➤ Financial Engineering of Securities➤ Contractual Nature of Securities requires Manual Intervention for Settlement and Processing➤ Valuation of Securities not actively traded➤ Collateral Monitoring and Risk Management➤ Integration of Information from Outsource Providers	

We discussed the complexity of the new products this morning. Now the focus is on the complexity versus our operational capabilities.

We are all saddled with legacy accounting systems that many firms have had for longer than twenty years. They are very difficult to modify, specifically if they are not the key core processing engine for new products like derivatives. So the ability to handle new products at scale is significantly challenged from an automation perspective. That is why we end up having to manually support many of these instruments from the moment they come to the market until we can get those legacy systems changed. The success factor for being able to do that is not very high, because the speed of financial engineering of securities can be much faster than the ability to modify legacy accounting systems.

Also, the contractual nature of the financial instruments we are dealing with today, especially derivatives, makes it almost impossible to automate that to a reasonable degree. The industry made some big steps in the last two or three years to accommodate that, but we are a long way from real straight-through processing that would create the efficiency we need.

We talked about valuation of securities that are not actively traded this morning. Hedge funds have the luxury of not having to price their units every day but basically at intervals they choose themselves. Franklin Templeton has to be able to calculate the Net Asset Value of the funds it manages every day, and we have to get the valuation right. This is a major challenge for our industry as a whole, and a high risk prospect as well.

All of this is building up to a view that the risk profile we are creating in the industry is substantially higher than at any time in its history. As a consequence of that, the collateral monitoring and

management process has become a very high profile task. This is particularly key with derivatives. Managing margin calls can be a massive task if you have multiple clients, multiple counterparties and multiple agreements to follow. Not everybody has been able to automate that. We find that it is still challenging even for firms that have been doing this for a long time.

When we were putting the symposium program together, we debated whether Alpha really adds something above the Beta. Reality is that there are many clients who are looking for Alpha. We as asset managers have to come to grips with how far out the risk scale we are willing to go. An asset manager could effectively risk its own reputation by creating a product that ultimately fails.

When we are looking at our counterparties with whom we trade these new instruments, we tend to think that we are comfortable if we are doing business with only the most reputable counterparties. The recent market events have shown that things have changed. Our industry is much more vulnerable than we thought, because reputation is everything.

Our monitoring of risk has clearly stepped up a notch in the last two years, making sure that we understand the risk profile that we are creating in every product. We continuously monitor that on a daily basis. That creates an operational challenge, because it requires much more accuracy and granularity in the information that is needed to adequately monitor those risks.

Integration of information from outsource providers: At Franklin Templeton, we do a large amount of fund accounting, institutional accounting and transfer agency work internally. We are somewhat unique in that respect. But we cannot do everything in-house. When we find that we do not have the scale or the know-how to do a process internally, and we can identify a business partner who does, we are more than happy to outsource. But when you outsource, you must always remember that you outsource just the work, not the fiduciary responsibility.

Once we outsource the work, we also need to bring the results back into the organization, so as to have a complete picture for tax, compliance, regulatory and internal management reporting.



Franklin Templeton grew over time. We became a global player by buying local asset management companies and then integrating them. The businesses remained local for a long time. This has changed. Now we take products from our local asset management groups, repackage them and distribute them all over the world. The arrows in this picture show a small selection of the interrelationships between the asset management, the sub-advisers and the distribution channels.

We now have asset managers that distribute products into different regulatory regimes, with different tax consequences, different compliance rules, different overall challenges in terms of the registration and management of a given portfolio. This adds challenges for the product development and sales units, but obviously for the back office as well.

LACK OF STANDARDS ACROSS MARKETS	
<ul style="list-style-type: none">➤ Giovannini Group – 15 Barriers to Clearing & Settlement➤ Investor Protection Initiatives - MIFID➤ Tax Treatment of Income & Capital Gains➤ Developed vs Emerging vs Frontier Markets➤ Market Acceptance of New Security Types➤ Regulatory Requirements for Retail vs SMA, etc	

Having more standards implemented in operations across markets would be a big relief. Removing the 15 Giovannini Barriers in Europe is a good start. If the operations backoffice does not have standards, it will not be possible to achieve the cost efficiency through scalability which we are expected to have. It is not just the fund manager's backoffice cost, it is the custodian's and the market infrastructure costs as well. All those costs are ultimately passed on to the consumer, who is the fund shareholder or the beneficiary of a pension plan.

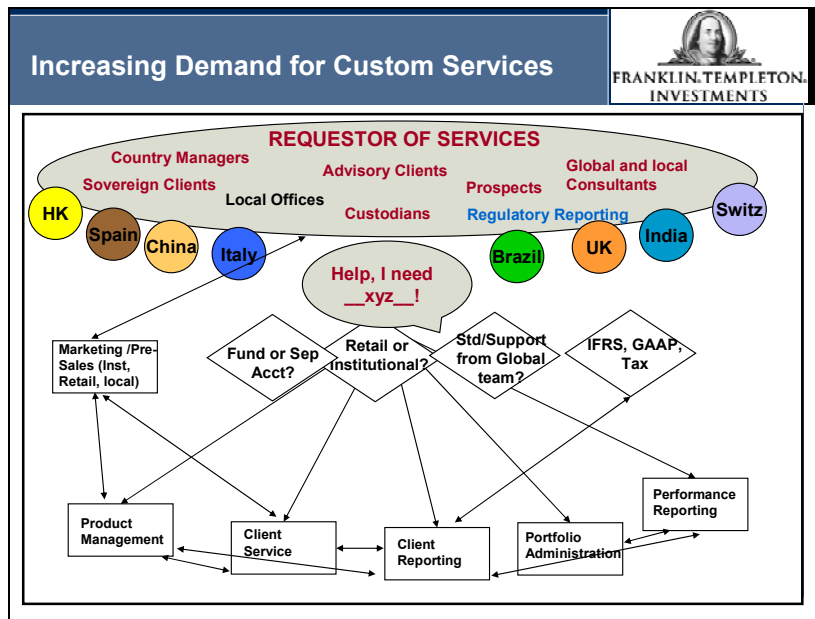
At the same time, the regulators are passing ever more directives that are intended to protect the ultimate investor. This is a good thing, but it also adds new layers of reporting cost on each one of us: the distributor, the custodian, the investment adviser, the market infrastructure.

Less complexity in handling the different tax regimes between different countries would be a great achievement. When you are selling a mutual fund into various countries, the different tax factors, which have to be reported to the respective governments or to the shareholders, are just enormous. The complexity and granularity of the information they are asking for is a huge challenge. We have many tax attorneys and accountants looking after this. This applies even to the European Union which is comparatively far advanced in terms of cross-border harmonization.

If the permutations are immense in the well developed markets, it gets even worse in the newer markets.

Historically, regulators tended to apply simple criteria for accepting investment instruments: If it was not traded on an official exchange, it was not a security and therefore not eligible for a fund open to the general public. The current view has changed. Regulators are beginning to recognize the fact that there *are* viable instruments that are not exchange-traded. Inclusion of these instruments for tax calculation purposes makes compliance with these rules and regulations more complex.

Last but not least, we increasingly have diverging regulations depending on whether we are handling retail accounts, institutional or Separately Managed Accounts. Obviously there are special rules overseeing pension funds in most countries. However, the retail space tends to have a more extensive web of regulatory controls and restrictions, than the pension space. We should understand that the portfolio manager is managing the investment mandate, which is then distributed into both channels.



It is a tribute to the growing sophistication of our clients around the world that they want to know a lot more details about their investments. Historically, it was enough to send them an asset statement once every quarter. Now, they want to know a lot more about information such as risk profiles of their portfolios or performance attribution. On top of that, we have the regulatory reporting which is becoming more and more demanding, including multiple reporting standards such as IFRS and GAAP reporting for registered products. In addition, this may be required in multiple languages. And the culmination is that all parties want all of those services for free!

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- **Standardized Global Systems**
 - **Technology Efficiencies to Provide Scalability**
 - **Data Warehouse to Support Custom/Adhoc Reporting**
 - **Centralizing Functions to Reduce Training Costs**
 - **Risk Management Controls to Reduce Errors**
 - **Global Sourcing for Compensation Arbitrage**

To be able to provide all those services which the different stakeholders require, and at reasonable cost, this is how we are trying to respond:

Our challenge has been to create a standardized global system through which our investment advisers enter their trades and manage their portfolios. We feed that data into our centralized accounting systems. Those, for the most part, are legacy systems which remain difficult to modify.

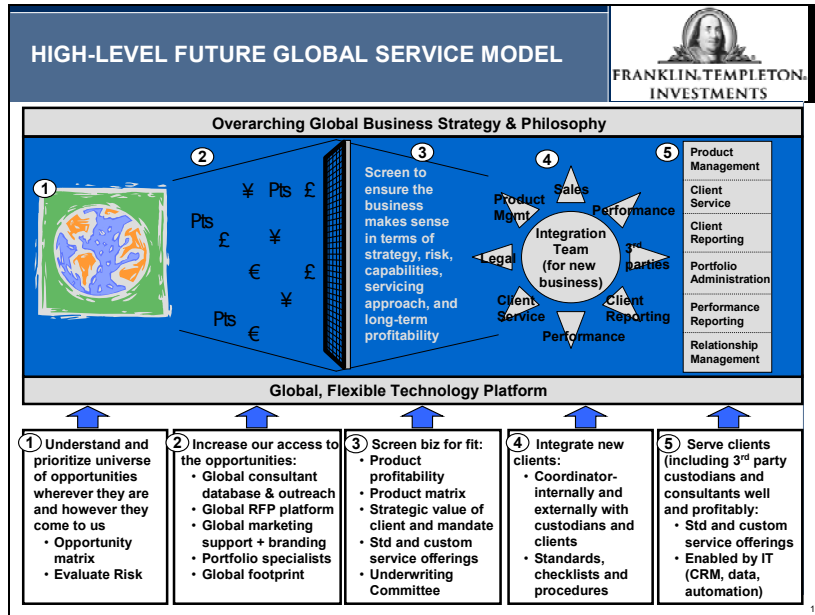
We look at technology efficiencies, and this is where the custodians and the market infrastructures could help: By creating a tighter integration with our counterparties and by using common standards, we can make progress in straight-through processing and reduce everyone's cost.

We create data warehouses to support ad-hoc reporting.

We try to centralize our functions physically to reduce our overall training costs.

We tighten risk management controls to reduce errors. It is a phenomenon in our industry that, for as long as the performance of a mutual fund or a pension client is high, nobody cares about operations. As soon as performance goes down, operations all of sudden is a huge problem....

And we are using global sourcing to benefit from compensation arbitrage and to gain access to incremental labor pools. It is increasingly challenging to recruit enough qualified staff to manage complex products in all the markets in which we operate.



One final slide, a holistic view of our world which we used for our senior management to bring the following message across:

There are many business opportunities out there. What we need to do, is to properly screen our existing and potential clients and make sure that we bring the right opportunities into our organization, based on our cost structure and based on their requirements. Some customers may want us to go too far out on the risk scale in terms of the products we manage, and that puts our whole franchise at risk. But at the same time, even if they are within our risk profile, we need to make sure that we can meet their demands in terms of custom reporting and other special requirements. Finally, we need to integrate all these considerations into our overall business strategy and make sure that all parts of our business can adequately support our customer.

Dean Chisholm



I will first talk a bit about Asia as a region, secondly about mutual funds, and thirdly about some of the challenges that are on the wish list of the service providers in Asia.

Asia is only a region on an atlas

- Segmentation by country is the norm for products and regulations
- Wealth, Saving and Cost dynamics vary greatly by country
- Little to no drive for regional convergence and integration
- Some opening of previously closed countries
- Historically a region TOO big and diverse for any institution to dominate a segment of the value chain (operations or distribution) across all countries. This creates opportunities!

Invesco

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Asia as a Region

Asia is one region only on a world map, but not in any other respect. Geographically it is huge, but it is very segmented for investment products and regulations. Let me give you a few random examples:

In China and Japan, there are requirements to do the fund valuation twice. The service provider has got to do it, the fund manager has got to do it, and then the results must be compared. That tends to be unproblematic for domestic funds. It immediately becomes a challenge when you operate cross-border funds, and especially so if you depend on fair value pricing.

Taxation is another example. Australia has a capital gains tax modeled on the UK but much more complex. By contrast, in Hong Kong there is basically no tax on capital gains and interest, and top income tax rates are very low in comparison. Tax differences between countries are very complex to mirror in accounting systems at the back end of transaction processing and reporting.

Because of that diversity, savings and cost dynamics also differ widely by country. Some of the savings dynamics were discussed this morning in the distribution segment. Some countries have an extreme short term investment view, others like Australia are much more long term oriented, with forced savings under their pension regulations.

Jimmy Gambill had the removal of the 15 Giovannini Barriers in Europe on his wish list. If you come to Asia, there is not even a common list of things to consolidate yet. This is unlikely to change in the near term. However, some of the countries in Asia have opened up their markets, and that creates great opportunities for our businesses.

India is an example of a very large market that, until recently, was virtually closed to foreign competitors and certainly to foreign products. Now you can sell some foreign products in India. India is opening slowly.

China is opening much faster. In 2007, five domestic funds were launched by foreigners in China. The regulations capped the amount that could be subscribed at two billion USD. Most funds raised more than that and the fund managers unfortunately had to give part of the money back to the investors!


The region is too big for any one firm to dominate a segment of the value chain, be it in distribution or in operations. Different competitors experience different degrees of success, depending on the country they try to enter. There is for instance no universal firm for fund accounting services in Asia. You have to shop in many different places which means you have to cope with different data requirements everywhere you go.

However, that also creates opportunities.

Mutual Funds

Mutual fund products

- Local or European products (Luxembourg/Ireland)
 - The balance varies by country
 - Fund manufacturers would like to sell across borders to reap economies of scale and broaden product offerings
 - Individual countries want to promote their own industries, which is at the expense of cross border funds
 - Pension systems lead to local products
 - Going forwards, clearly a role for local products to lesser or greater extent
- Few service providers are present in more than a few segments, although slowly changing
- All markets becoming more sophisticated, but with differing starting points, today
 - HIGH (*Australia, Japan*) - alternatives are popular, financial planning is the norm
 - MEDIUM (*Hong Kong, Singapore, Taiwan*) – high consumption of international products with short investment horizons
 - LOW (*China, India*) – just starting to look at international investment, low level of advice given by intermediaries



Mutual funds have been an old product in Asia, certainly in some markets like Hong Kong, Singapore and Taiwan. It differs very much though by country.

Most international fund managers would love to sell their European products in Asia, because that would create economies of scale. Adding another dealing currency would be quite easy. However, that often does not fit in with the intentions of the target market.

Most markets want to develop a fund management industry of their own. As a result, they tend to produce protectionist rules. At the same time, many countries have the ambition to become a regional center for fund management – the two interests obviously bite each other! That has led to a broad range

of local products. Those local products follow rules made by their local regulators which are not aligned with regulations in other markets. That is a root cause of complexity.

There is institutional business in Asia. However that is typically not pension funds but rather sovereign funds. The pension fund industry in Asia is quite new. Here again, the different markets devised their own systems and strategies. Some service providers considered them too risky and exited the business. As a result, if you look across the pension fund industry, the choice amongst service providers currently is not that great. It is often difficult to find enough names even for a short list when it comes to conducting RFPs for pension fund administration. That said, currently there are plenty of new entrants to this business.

When you look at the markets themselves, they are not uniform and at different stages of development. International firms are asked to support very different service levels.

In Japan and Australia, you have complex investment products and strategies to support operationally.


In the middle level, you have markets with a high consumption of international products. Those can be relatively easy to handle, but investors' time horizons tend to be very short and that puts on new challenges. If you look at the transfer agency side of the business, you have to be able to handle volume peaks at very short notice. Typically, Asian fund markets are an omnibus account-type of business; we typically do not take individual orders. Yet, you have to be able to scale up by a factor of ten within a month. If a particular market or product really takes off, huge volumes accumulate quickly.

At the bottom end, there are the markets which are just starting to open up to international investing. I mentioned China and India already. There is also a lower level of investment advice given in those markets, which can make them difficult for a fund manager in terms of predicting what size of capital inflows a certain product might attract. If you have your own advisers in the market, at least the sale cycles tend to be a bit longer than elsewhere.

Challenges for Operations

Challenges for Operations

- Not too difficult to run the equity investment process on international systems in most markets. PRC is the major exception.
- Fund accounting, NAV and transfer agency systems will only work across a number of relatively open countries, not across the whole region. Languages (double byte characters), tax, local accounting & reporting plus the actual product and company regulations are the barriers. Opportunities for those with powerful operations and systems to reap economies of scale
- Local systems and third party providers are subscale. Opportunities for consolidation
- Local distributors and fund manufacturers are cash focused rather than value or risk orientated. Resulting in manual processes (except PRC). Opportunities for industrialisation of processes.
- Varying degrees of acceptance or viability of outsourcing Operations. Opportunities for market expansion.
- Long term need for the same or higher standards of service than in Europe or North America.



Running an equity investment process operationally has become pretty simple nowadays. The challenge is just to roll out the same processing platform across the different markets. A big exception is China, which is a new market entrant. There is just one dealing system you can use in China, and how they deal on the local exchanges is totally different from international standards.

Fund accounting, NAV calculation and transfer agency systems need a lot of customization by market. If you are lucky, one system works for a small number of similar markets, but not across the whole region. Some outsourcing specialist providers are trying to tackle this, but even they are struggling. Local rules

and regulations are intricate. It is the details that are often the killers for international software systems. Many work-arounds are required to accommodate language, reporting specialties etc. There is also a huge diversity in terms of data you need to collect at the operations end to satisfy the local regulatory reporting requirements. That creates opportunities for outsourcing service providers. Most local fund management companies can not get economies of scale by doing this on their own.

Local systems and third party service providers are subscale. In a country with 40 fund managers, 40 accounting system sales can be made. That is your market place. But no provider of complex software can price their product for a market with just 40 potential customers. China currently has 55 fund managers and two providers of transfer agency and related services. Their local annual software maintenance cost is about the equivalent of 2.5 full-time employees. That is not economic software in the long term. There has to be better software, consolidation and economies of scale across these markets. Individual fund managers are probably not going to make this happen, as they are too busy chasing their distributors to sell their products.

At the same time, a number of the local players in the market places, both in fund manufacturing and fund distribution, are very cash focused. We, together with a group of ten international fund managers, have tried to win distributors over to electronic order flow on the retail side. But, for instance, most Taiwanese distributors will not send you a SWIFT message because it costs them 25 Euro Cents. A fax in their perception costs nothing. Trying to move them away from a cash orientation to a value orientation, with the associated benefit to client service, is a real challenge. If you look at the typical local back office for funds, they are likely to have only around two staff. If you bring them efficiency gains which would save half of their back office work, they would not make the second person redundant, because then there would not be cover in case the remaining back office person wanted to take a leave. So there are still a lot of manual processes. It is somewhat scary to see how much Excel there is in mutual fund operations! The exception here is China which came late to the game. The China Securities Regulatory Commission (CSRC) in many cases mandated file formats and forced people into electronic work flows.

Overall, there is still a lot of room for the industrialization of processes in what is essentially still a cottage industry.

When you look across the industry in Asia, there are varying degrees of the acceptance of outsourcing of operations. For the service providers, that means they still have many opportunities. I give you a small example: In April 2008, we completed the outsourcing of our own transfer agency business in Taiwan, for our domestic Taiwanese funds. We were the first firm to do this in Taiwan which has about 40 fund managers. Everybody had told us that it could not be done; nobody was doing it. The regulations were not written for that scenario, but it turned out that nobody had asked the regulator about it. Sometimes you just have to challenge the conventional norms in order to push the barrier a bit, by telling the regulators about international best practice. But the reluctance towards outsourcing is still strong. Regulators often still believe that the fund manager ought to do everything on its own.

In the long term, Asian investors will demand the same as or even higher quality standards for back office services, than investors do in Europe or North America. This has been true for Japan already for a number of years. The concept of quality in Japan is extremely high. The domestic market in Japan does not know failed trades. Having to explain to a client that there is a failed trade in an international market, is hugely difficult if it is a private pension fund. If it is a government pension fund you probably lost your mandate. This is the reality. We see the same coming now in China, especially for the sovereign funds. But when investing in international markets, you do have failed trades. And even under a contractual settlement program you do not always get the money or the asset on the contractual date. But often, when the custodian has sold his product to the client, that is what the client thinks he is getting, without any exception.

That in a nutshell is Asia – a lot of challenges, yet a land of opportunity. A land to invest money in, but you have to commit and be prepared to go for the hard tour.
