lakyara vol.177

Foreign-domiciled investment trust order processing should be automated

Takayuki Nakata

10. October. 2013

Nomura Research Institute, Ltd.

Executive Summary

Foreign-domiciled investment trust assets are growing, but most orders to purchase or redeem shares in such investment trusts are still processed manually. The investment trust industry should swiftly automate order processing to reduce workloads, lessen the risk of clerical errors and, in turn, avert a loss of confidence in foreign-domiciled investment trusts.

Takayuki Nakata
Consultant
Asset Management Systems Business Department

Foreign-domiciled investment trust orders are largely processed manually

The investment trust market is booming in the wake of recent equity market gains and yen depreciation. Foreign-domiciled investment trusts in particular are gaining popularity. At June 30, 2013, foreign-domiciled investment trusts marketed directly to Japanese investors had assets under management (AUM) of some ¥6.5 trillion, a 26% year-on-year increase[1]. As of the same date, foreign-domiciled investment trusts in which Japanese investors can invest through fund-of-funds (FoF) had AUM of roughly ¥17 trillion[2], nearly three times directly marketed foreign-domiciled investment trusts' AUM. As foreign-domiciled investment trusts' AUM has grown, the workload of Japanese fund distributors and trust banks that transmit purchase/redemption orders directly to overseas transfer agents[3] has been steadily increasing.

Among foreign-domiciled investment trusts available in Japan, the most popular domiciliary country is Luxembourg with a 44.9% share[4]. According to a survey jointly conducted by the European Fund and Asset Management Association (EFAMA) and SWIFT, processing of most fund orders and confirmations transmitted between Asia and transfer agents in Luxembourg is not automated. The share of such communications transmitted by manual means (e.g., e-mail, fax) is a hefty 56%, higher than in other regions (Exhibit 1). Detailed country-by-country data are not available, but even in Japan most cross-border fund orders are presumably still processed manually. One likely reason for the continued prevalence of manual processing in Japan in particular is that more efficient workflows have yet to take root among asset management companies, trust banks and transfer agents amid the rapid growth in FoFs and FOF-investee investment trusts' AUM since a former ban on FoFs was lifted in 2000.

NOTE

1) Per Japan Securities Dealers Association (JSDA) data (http://www.jsda.or.jp/shiraberu/foreign/info4/).

2) NRI estimate based on data from multiple sources.

3) Transfer agents handle issuance and redemption of fund shares. Their functions include opening investor accounts, processing cash receipts and disbursements, re-titling fund shares, and preparing and distributing various reports. In Japan, these functions are fulfilled by asset management companies.

4) Per JSDA data current as of 31 March 2013 (http://www.jsda.or.jp/shiraberu/foreign/info4/id4_gaikyo.html).

The manually processed share of investment trust orders, multiplied by foreign-domiciled investment trusts' AUM, implies that some ¥13 trillion of investment trust orders are processed manually. Heavy reliance on manual processing leads to heavy workloads and clerical errors, but automation rates in other regions suggest that there is scope for greater automation in Asia.

Exhibit 1. Manually processed share of fund orders (by region)

Source: NRI, based on Fund Processing Standardisation: Annual Report on automation and standardisation of cross-border funds orders in 2012

Example of and challenge posed by fund order flow

Exhibit 2 presents an example of how fund distributors and trust banks communicate with other parties when transmitting foreign-domiciled investment trust purchase/redemption orders. The foreign-domiciled investment trust's distributor aggregates orders from domestic investors and notifies the transfer agent of purchase/redemption orders. The fund distributor receives information on fund distributions and account balances from the transfer agent in addition to purchase/redemption confirmations. It also receives NAV data from the fund administrator and settlement confirmations from the custodian.

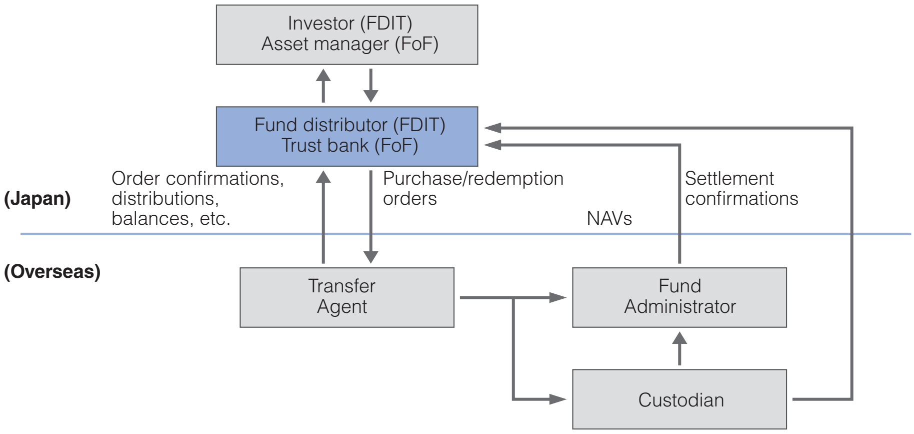
The communication flow is largely identical between foreign-domiciled investment trusts marketed directly to domestic investors and FoF-investee foreign-domiciled investment trusts. In the case of FoFs, the fund distributor's role is fulfilled mainly by a trust bank because transmission of purchase/redemption orders is considered part of trust banks' asset trustee duties[5].

5) Investors sometimes contact the transfer agent directly (e.g., due to time constraints).

Domestically, the automation rate for order flow between investors and fund distributors is quite high. In the case of FoFs, however, communications between asset management companies and trust banks are still largely conducted manually. Trust banks generally receive portfolio management instructions in different forms from multiple asset managers. This lack of uniformity increases their workload.

As mentioned above, neither fund distributors nor trust banks have made much progress in automating their communications with overseas parties; they still conduct much of their overseas communications manually. According to our contacts, a single fund distributor or trust bank transmits purchase/redemption orders to as many as 20 transfer agents. Transmitting orders under time constraints in the formats respectively required by different transfer agents is highly problematic from the standpoint of not only workload but also clerical errors and risks. Another factor adding to fund distributors and trust banks' workloads is that incoming information from overseas parties is manually received and entered into their accounting systems.

Exhibit 2. Example of communications between trust banks and overseas parties



N o t e : FDIT: foreign-domiciled investment trust
Source: NRI

Confidence in foreign-domiciled investment trusts could be shaken

Several European securities clearing houses offer network services that smoothly transmit purchase/redemption orders to transfer agents, thereby reducing workloads. However, the services are not yet widely used in Japan for at least two reasons. First, such services are not used widely enough by transfer agents with which Japanese users do business. Second, in the case of FoFs in particular, the services would not fully alleviate trust banks' workloads unless they are used by asset managers also. What are needed are services that offer comprehensive, not partial, solutions.

While foreign-domiciled investment trusts' popularity will be affected by future tax reforms[6], the AUM of foreign-domiciled investment trusts sold directly to domestic investors or available through FoFs are likely to continue growing in light of demand for receptacles for foreign-currency bonds and deposits. If such AUM growth results in increased workloads, it would increase the risk of clerical errors. Clerical errors in processing of fund purchase/redemption orders could adversely affect asset managers and investors directly and potentially undermine confidence in foreign-domiciled investment trusts. Such a risk should not be taken lightly. The investment trust industry should swiftly automate fund order processing for the sake of its own self-interest.

6) Unified taxation of financial income, effective from 2016, could reduce foreign-currency money market funds' advantage over foreign-currency deposits.

about NRI

Nomura Research Institute, Ltd. ("NRI", TYO: 4307) is an independent, global IT solutions and consulting services provider with annual sales of 363.9 billion yen as of FY ended March 2013. With front-to-back support for the buy- and sell-side, NRI's tradition of innovation has positioned them as a trusted international market leader. Leveraging NRI's global consulting business, NRI is able to provide innovative financial IT solutions for investment banks, asset managers, banks and insurance providers. For more information, visit www.nri.com.

Inquiries to : Financial Technology and Market Research Department
Nomura Research Institute, Ltd.
Marunouchi Kitaguchi Bldg.
1-6-5 Marunouchi, Chiyoda-ku, Tokyo 100-0005, Japan
E-mail : kyara@nri.co.jp

http://www.nri.com/global/opinion/lakyara/index

